Draft Regulations

Securities Act
(R.S.Q. c. V-1.1, s. 331.1, pars. (11), (32), (33.8) and (34), and s. 331.2)

Regulation to amend Regulation 23-103 respecting Electronic Trading and concordant regulation

Notice is hereby given by the *Autorité des marchés financiers* (the "Authority") that, in accordance with section 331.2 of the *Securities Act*, R.S.Q. c. V-1.1, the following Regulations, the texts of which are published hereunder, may be made by the Authority and subsequently submitted to the Minister of Finance for approval, with or without amendment, after 90 days have elapsed since their publication in the Bulletin of the Authority:

- *Regulation to amend Regulation 23-103 respecting Electronic Trading.*

Draft amendments to the following regulations are also published hereunder:

- *Regulation to amend Regulation respecting Passport System.*

Draft amendments to the *Policy Statement to Regulation 23-103 respecting Electronic Trading* are also published hereunder.

Request for comment

Comments regarding the above may be made in writing by **January 23, 2013**, to the following:

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Further information

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October 25, 2012

CSA NOTICE AND REQUEST FOR COMMENT

DRAFT *REGULATION TO AMEND REGULATION 23-103 RESPECTING ELECTRONIC TRADING*

I. INTRODUCTION

Today the Canadian Securities Administrators (CSA or we) are introducing draft amendments (Draft Amendments) to *Regulation 23-103 respecting Electronic Trading* (Regulation 23-103) and *Policy Statement to Regulation 23-103 respecting Electronic Trading* (Policy Statement) that would, in part, impose requirements on participant dealers that provide direct electronic access (DEA).[1] The Draft Amendments are being published for a 90-day public comment period. The text of the Draft Amendments is published with this Notice and will also be available on the websites of various CSA jurisdictions.

We have worked closely with staff of the Investment Industry Regulatory Organization of Canada (IIROC) in developing the Draft Amendments and we thank them for sharing their knowledge and expertise. IIROC is also publishing amendments to the Universal Market Integrity Rules (UMIR) and its dealer member rules for comment to reflect and support the Draft Amendments. More information may be found at www.iiroc.ca.

Jurisdictions that are a party to *Regulation 11-102 respecting Passport System* (currently all jurisdictions except Ontario) are also republishing for comment amendments to that regulation that permit the use of the passport system for aspects of Regulation 23-103. The amendments were published for comment on August 19, 2011. No comments were received. These related amendments are published with this Notice.

II. BACKGROUND

On April 8, 2011, we published for comment proposed Regulation 23-103 and Policy Statement (2011 Proposal). The 2011 Proposal included requirements and guidance specifically related to DEA.

On June 28, 2012, the CSA published Regulation 23-103 and the Policy Statement in their final form which have now been adopted by each member of the CSA and will come into effect on March 1, 2013. However, the CSA finalized Regulation 23-103 and the Policy Statement without specific DEA provisions. The CSA delayed the DEA provisions in Regulation 23-103 to ensure that the CSA requirements related to DEA are consistent with IIROC's proposed amendments on DEA and that similar forms of marketplace access would be subject to similar requirements. The Draft Amendments cover only DEA and are substantially similar to those that were published in the 2011 Proposal but for a few changes that are described in this Notice. The IIROC proposal applies to not only DEA but situations where dealers route orders to other dealers. We are of the view that the proposed package of

[1] A participant dealer is defined in Regulation 23-103 as a marketplace participant that is an investment dealer.

IIROC and CSA amendments, taken together, will ensure that similar forms of marketplace access and the risks that arise from these forms of access are treated similarly.

III. SUMMARY OF KEY COMMENTS RECEIVED BY THE CSA

We thank all 29 commenters for their submissions in response to the 2011 Proposal. A list of those who submitted comments, a summary of comments related to the DEA-specific provisions contained in the 2011 Proposal and our responses to them are attached at Annex A to this Notice. Copies of the comment letters are posted at www.osc.gov.on.ca. For additional background on the DEA-specific provisions included in the 2011 Proposal, please refer to the CSA notice that was published with the 2011 Proposal.[2]

IV. SUBSTANCE AND PURPOSE OF THE DRAFT AMENDMENTS

Requirements Specific to Direct Electronic Access

While technology has increased the speed at which trades take place, it has also enabled marketplace participants to facilitate access to marketplaces by their clients, whether large institutions or sophisticated retail clients. Under the Draft Amendments, DEA exists where a client uses the participant dealer's marketplace participant identifier (MPID) for the purpose of electronically sending orders to a marketplace. This type of access can include a client using the participant dealer's system for automated onward transmission to a marketplace or a client sending the order directly to a marketplace without going through the participant dealer's systems. Under the Draft Amendments, DEA would not include an order execution service provided pursuant to IIROC rules.[3]

Whether a participant dealer is trading for its own account, for a customer or is providing DEA, the participant dealer is responsible for all trading activity that occurs under its MPID. Allowing the use of complicated technology and strategies, including high frequency trading strategies, through DEA brings increased risks to the participant dealer. For example, the participant dealer may be held financially responsible for the execution of erroneous trades that occur under its MPID, even when these trades go beyond its financial capability. As well, a participant dealer may be responsible for a lack of compliance with marketplace or regulatory requirements for DEA orders entered using its MPID.

Therefore, appropriate controls are needed to manage the financial, regulatory and other risks associated with providing DEA to ensure the integrity of the participant dealer, the marketplaces and the financial system. To address this need, the Draft Amendments would provide a framework around the provision of DEA so that a participant dealer providing DEA manages these risks appropriately.

(i) Provision of DEA

Under the Draft Amendments, only a participant dealer, defined as a marketplace participant that is an investment dealer[4], may provide DEA.[5] We have proposed to limit the registrants that may use DEA to

[2] Published in the *Bulletin de l'Autorité des marchés financiers* of April 8, 2011, Vol. 8, No. 14, page 709.
[3] Subsection 1.2(2) of 23-103CP.
[4] Section 1 of Regulation 23-103.

a portfolio manager and restricted portfolio manager.[6] The 2011 Proposal allowed DEA to be provided to a participant dealer as well, however, the rules relating to dealer-to-dealer order routing will be dealt with in the proposed UMIR amendments that IIROC is publishing for comment today. As a result, we have removed this provision from the Draft Amendments. This is considered to be a significant change from the 2011 Proposal and therefore, we are republishing the provisions of Regulation 23-103 relating to DEA for comment at this time.

This proposed restriction in the Draft Amendments would not permit exempt market dealers (EMDs) to use DEA. In our view, dealers should be subject to UMIR if engaging in this type of equity trading.

The 2011 Proposal also proposed that an EMD would be prohibited in the use of DEA. The majority of comments received regarding this provision were not supportive of this proposed prohibition. Commenters cited that many U.S. broker-dealers are registered in Canada as EMDs in order to facilitate part of their business in Canada and that the 2011 Proposal would prevent such U.S. broker-dealers from being a DEA client. Others noted that it is inconsistent to allow unregistered firms or individuals to use DEA yet not allow EMDs to do so.

CSA staff announced in CSA Staff Notice 31-327, published September 2, 2011, that CSA registration staff will examine policy issues relating to firms registered as EMDs that are carrying out brokerage activities (trading securities listed on an exchange in foreign or Canadian markets). CSA Staff Notice 31-327 also stated that in the interim, CSA staff will consider registering these firms in the restricted dealer category with terms and conditions. Subsequently, the CSA published CSA Staff Notice 31-331 as a follow-up to this issue, which introduces IIROC Notice 12-0217 (IIROC Notice). The IIROC Notice proposes that firms registered as EMDs that are conducting brokerage activities become registered as Restricted Dealer member firms and become subject to IIROC oversight.

We therefore continue to think that registered dealers that provide brokerage services similar to those of investment dealers should also be subject to IIROC rules when doing so. Therefore the Draft Amendments maintain the proposed prohibition on EMDs from using DEA. We note that this restriction would not prevent an EMD from trading, it would only prevent EMDs from trading using DEA.

Some commenters noted that there may be entities that are registered as both a portfolio manager and an EMD. To accommodate for these instances, we have proposed that if a firm is registered as both a portfolio manager and an EMD, it would be eligible for DEA provided that it only uses DEA when acting in its capacity as a portfolio manager and not in its capacity as an EMD. If this firm uses DEA to place trades for its non-advisory clients, then we would consider it to be using DEA in its capacity as an EMD and therefore to be inappropriately using DEA. Similarly, if a foreign dealer is registered as an EMD, it would be eligible for DEA provided that it only uses DEA when acting in its capacity as a foreign dealer and not in its capacity as an EMD for Canadian clients.[7]

The 2011 Proposal did not place any specific limitations on the use of DEA by individuals and we continue to be of the view that certain individuals should not be excluded from obtaining DEA access.

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[5] Subsection 4.2(1) of Regulation 23-103.
[6] Subsection 4.2(2) of Regulation 23-103.
[7] Subsection 4.2(2) 23-103CP.

While in general we do not think that retail investors should use DEA, there may be circumstances in which sophisticated individuals that have access to the necessary technology and resources, such as former registered traders or floor brokers, can use DEA appropriately. In this type of circumstance and if a participant dealer establishes and applies appropriate client standards, we would consider it to be acceptable for individuals to use DEA.[8]

(ii) Minimum Standards for DEA Clients

While DEA clients are usually large, institutional investors with regulatory obligations, some DEA clients, as described above, may also be retail clients that have particular sophistication and resources to be able to manage DEA. A participant dealer must understand its risks in providing DEA and address those risks when establishing its minimum standards for providing DEA to each client. It would also be expected that a participant dealer would ensure that it can adequately manage its DEA business. For example, the participant dealer would need to ensure that it has the necessary staffing, technology and other required resources, as well as the financial ability to withstand the increased risks of providing DEA.

The Draft Amendments prescribe that before granting DEA to a client, a participant dealer must first establish, maintain and apply appropriate standards for providing DEA and assess and document whether each client meets these standards.[9] One of the first steps to addressing the financial and regulatory risks associated with DEA would require a participant dealer to conduct due diligence with respect to clients who are to be granted this type of access. This due diligence is key in managing the risks associated with providing DEA and would necessitate a thorough vetting of potential clients accessing marketplaces under its MPID.

A participant dealer's DEA standards would need to include that the client has:

- sufficient financial resources to meet any financial obligations that may result from the use of DEA by that client,
- reasonable knowledge of and proficiency in the use of the order entry system,
- knowledge of and the ability to comply with all applicable marketplace and regulatory requirements, and
- reasonable arrangements to monitor the entry of orders through DEA.[10]

We would consider the above standards to be the minimum necessary for a participant dealer to properly manage its risks, however the participant dealer should assess and determine whether it needs any additional standards given its business model and the nature of each prospective DEA client. For example, standards that may apply to an institutional client may differ from those that apply to an individual.

Unlike the current rules at the marketplace level related to DEA, the Draft Amendments would not set out an "eligible client list" that imposes specific financial standards for DEA clients. The CSA is of the view that a participant dealer should have the flexibility to determine the specific levels of the minimum

[8] Subsection 4.2(3) 23-103CP.
[9] Subsection 4.3(1) of Regulation 23-103.
[10] Subsection 4.3(2) of Regulation 23-103.

standards in order to accommodate its business model and appetite for risk. This is in keeping with global standards related to DEA.

In order to ensure that the established minimum DEA client standards are maintained, the Draft Amendments would oblige a participant dealer to confirm at least annually with each DEA client as to whether it continues to meet the DEA client standards established by the participant dealer.[11] Obtaining a written annual certification by the DEA client may be one way to meet this requirement.

(iii) Written Agreement

In addition to the minimum DEA client standards, the CSA think that certain requirements for the provision of DEA should be a part of every DEA arrangement in order to appropriately address the risks that DEA can pose to the Canadian market. Therefore, the Draft Amendments would require that before providing DEA, a participant dealer must have a written agreement with each DEA client that specifies that:

- the DEA client will comply with marketplace and regulatory requirements,
- the DEA client will comply with the product limits and credit or other financial limits specified by the participant dealer,
- the DEA client will take all reasonable steps to prevent unauthorized access to the technology that facilitates the DEA,
- the DEA client will fully cooperate with marketplaces or regulation services providers in connection with any investigation or proceeding with respect to the trading conducted pursuant to the DEA provided,
- the DEA client will immediately inform the participant dealer if it fails or expects not to meet the standards set by the participant dealer,
- when the DEA client is trading for the accounts of its clients, the DEA client will take all reasonable steps to ensure that its client orders will flow through the systems of the DEA client and will be subject to reasonable risk management and supervisory controls, policies and procedures,
- the DEA client will inform the participant dealer in writing of all individuals acting on the DEA client's behalf that it has authorized to use its DEA client identifier, and
- the participant dealer has the authority, without prior notice, to reject, vary, correct or cancel orders and discontinue accepting orders.[12]

While these requirements are expected to address many of the risks associated with providing DEA, a participant dealer may add provisions to the written agreement it thinks are necessary to manage its specific risks.

(iv) Training of a DEA Client

A participant dealer would also need to be satisfied that a prospective DEA client has reasonable knowledge of marketplace and regulatory requirements before providing DEA.[13] This proposed

[11] Subsection 4.3(3) of Regulation 23-103.
[12] Section 4.4 of Regulation 23-103.

requirement is meant to specifically address the market integrity risk that providing DEA can pose to the participant dealer. The participant dealer must therefore determine, what, if any, training its client requires to ensure that the client understands the applicable marketplace and regulatory requirements and how trading on the marketplace system occurs to help mitigate this risk. We are not proposing any specific type of training to be provided; however, depending on the client and the trading it plans to do, the participant dealer may require it to take the same types of courses as is required for an approved participant under UMIR.

(v) DEA Client Identifiers

In order to allow regulators to identify DEA trading more readily and determine the specific client behind each trade more easily, the Draft Amendments would require that a participant dealer assign each DEA client a unique identifier that must be associated with every order it sends using DEA.[14] We would expect the participant dealer to work with the various marketplaces to assign these identifiers and ensure that each order entered on a marketplace by a DEA client using DEA includes this identifier. This practice is currently being followed on certain marketplaces and the CSA believe that mandating this practice across all marketplaces would assist the CSA, exchanges conducting their own market regulation, and regulation services providers in carrying out their regulatory functions.

(vi) Trading by DEA Clients

Due to the risks associated with providing DEA, the CSA think that DEA clients should not pass on their DEA access to their clients. Allowing such behaviour would exacerbate the risks DEA poses to the Canadian market and may widen the breadth of market access to participants who do not have any incentive or obligation to comply with the regulatory requirements or any financial, credit or position limits imposed by participant dealers. Therefore, the Draft Amendments would prohibit a DEA client from providing its DEA to another person.[15]

To contain the use of DEA and thereby limit the risks it poses to a marketplace participant and the market as a whole, the Draft Amendments would generally only allow a DEA client to trade for its own account. However, certain DEA clients, specifically those that are portfolio managers, restricted portfolio managers and any entity that is registered in a category analogous to the portfolio manager or restricted portfolio manager category in a foreign jurisdiction that is a signatory to the IOSCO Multilateral Memorandum of Understanding would be allowed to trade using DEA for the accounts of their clients.[16]

V. SUMMARY OF CHANGES TO THE DEA RELATED PROVISIONS

After considering the comments received and in order to complement the IIROC proposed amendments related to marketplace access, we have made some changes to the DEA related provisions included in the 2011 Proposal. The Draft Amendments that we are publishing today reflects those changes.

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[13] Subsection 4.5(1) of Regulation 23-103.
[14] Section 4.6 of Regulation 23-103.
[15] Subsection 4.7(1) of Regulation 23-103.
[16] Subsection 4.7(2) of Regulation 23-103.

This section describes the key changes made to the proposed DEA related provisions since the 2011 Proposal.

(i) Definition of Direct Electronic Access

We have revised the proposed definition of direct electronic access to more clearly state that it includes the transmission of an order using a person's marketplace participant identifier through the person's systems for automatic onward transmission to a marketplace or directly to the marketplace without being electronically transmitted through the person's systems.

(ii) Application of Requirements Applicable to Participant Dealer Providing Direct Electronic Access

A new proposed provision would not apply the proposed requirements applicable to a participant dealer providing DEA if the participant dealer complies with similar requirements established by a regulation services provider, a recognized exchange that directly monitors the conduct of its members and enforces requirements set under subsection 7.1(1) of Regulation 23-101 or a recognized quotation and trade reporting system that directly monitors the conduct of its users and enforces requirements set under subsection 7.3(1) of Regulation 23-101. **Since the Draft Amendments cover the trading of all securities and set the minimum requirements that must be complied with by all participant dealers, we request feedback on whether there should be an exemption from Part 2.1 of Regulation 23-103 provided to a participant dealer if it complies with similar requirements established by a recognized exchange or quotation and trade reporting system that directly monitors the conduct of its members and enforces requirements. Similarly, solely with respect to standardized derivatives, should there be an exemption provided to a participant dealer if it complies with similar requirements established by a regulation services provider or a recognized exchange or quotation and trade reporting system that directly monitors the conduct of its members and enforces requirements?**

(iii) Provision of Direct Electronic Access to Registrants

The 2011 Proposal permitted a participant dealer to provide direct electronic access to registrants that were participant dealers or portfolio managers. In order to complement the proposed IIROC amendments related to marketplace access, the Draft Amendments would not allow participant dealers to provide DEA to other participant dealers, as this is dealt with under the IIROC amendments. Another change is that the Draft Amendments would allow participant dealers to provide direct electronic access to restricted portfolio managers. We view the risks of providing DEA to a restricted portfolio manager or a portfolio manager to be similar.

(iv) Written Agreement

The Draft Amendments include a new provision in the written agreement between a participant dealer providing DEA and its DEA client. This new obligation would require a DEA client to inform the participant dealer, in writing, of all individuals acting on the DEA client's behalf that it has authorized to use the DEA client identifier to the participant dealer and to update this list as necessary.

(v) Form of DEA Client Identifier

The Draft Amendments would introduce a new requirement related to the DEA client identifier. Specifically, the DEA client identifier would need to be assigned in the form and manner required by a regulation services provider, or a recognized exchange or recognized quotation and trade reporting system that directly monitors the conduct of its participants.

(vi) Provision of DEA Client Identifier to Marketplaces

As well, the Draft Amendments would require a participant dealer that assigns a DEA client identifier to immediately provide the DEA client identifier to each marketplace to which the DEA client has direct electronic access through the participant dealer. Added guidance in the Policy Statement explains that the CSA do not expect a DEA client's name to be disclosed to a marketplace, merely the DEA client identifier which will allow a marketplace to more readily identify DEA flow.

(vii) Clarification re Maintaining Technology Facilitating Direct Electronic Access in a Secure Manner

We have proposed a clarification in the Policy Statement that all reasonable steps required to be taken to prevent unauthorized access to the technology facilitating DEA are to be commensurate with the risks posed by the type of technology and systems that are being used.

(viii) Authorization of Employees Using DEA Client Identifier

We have added proposed guidance to the Policy Statement explaining that a DEA client must formally authorize individuals that will be using the DEA client identifier when trading for the DEA client.

(ix) Training of DEA Clients

The Draft Amendments also include proposed guidance in the Policy Statement that explains when, after DEA has been granted, a re-assessment of the DEA client's knowledge of applicable marketplace and regulatory requirements would be considered necessary and what the participant dealer could do to address deficiencies in the DEA client's knowledge.

(x) Use of DEA by Entities Registered as an EMD and as a Portfolio Manager or Restricted Portfolio Manager

The proposed guidance in the Policy Statement would include a clarification about an EMD's use of DEA if it is also registered as a portfolio manager or restricted portfolio manager. The guidance also clarifies when a foreign dealer that is also registered as an EMD is eligible for DEA.

VI. AUTHORITY FOR THE DRAFT REGULATION

In those jurisdictions in which the Draft Amendments are to be adopted, the securities legislation provides the securities regulatory authority with rule-making or regulation-making authority in respect of the subject matter of the Draft Amendments.

VII. REQUEST FOR COMMENTS

We invite all interested parties to make written submissions with respect to the Draft Amendments.

Please submit your comments in writing on or before January 23, 2013. If you are not sending your comment by email, send a CD containing the submission (in Microsoft Word format).

Please address your submission to all of the CSA as follows:

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

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

M[e] Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
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and

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
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Toronto, Ontario M5H 3S8
e-mail: comments@osc.gov.on.ca

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of written comments received during the comment period.

The text of the Draft Amendments is being published concurrently with this Notice.

VIII. QUESTIONS

Please refer your questions to any of the following:

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Shane Altbaum Legal Counsel Alberta Securities Commission 403-355-4475 shane.altbaum@asc.ca	

October 25, 2012

Annex A

Comment Summary and CSA Responses

ICE Futures Canada, Inc.	TriAct	IRESS
CanDeal	Flextrade Systems Inc.	Ross McKee
CIBC	PMAC	CNSX Markets Inc.
TMX Group	Akimbo Capital LP	Optima Capital Canada
ExpoWorld Ltd.	Heaps Capital Ltd.	EMDA
Chi-X ATS	Newedge Canada Inc.	Mark DesLauriers
TD Securities	LiquidNet Canada Inc.	GETCO
Jitneytrade Inc.	Softek	SIFMA
Simon Romano & Terrence Doherty	Alpha ATS	IIAC
Penson Financial Services Canada	Scotia Capital	

Please note that a summary of comments relating to proposed requirements included in the 2011 Proposal, other than those related to direct electronic access, was published on June 28, 2012.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
Definitions	**Definition of "Direct Electronic Access"** A number of commenters requested further clarity as to what is intended by "additional order management" by a participating dealer in the definition of direct electronic access. Certain commenters queried whether the use of a participant dealer's risk controls or smart order router would constitute "additional order management".	The Draft Amendments include a revised definition of direct electronic access that does not include the phrase "additional order management". The Draft Amendments would further clarify

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
		in the Policy Statement that an order generated by an automated order system used by a DEA client and transmitted using the participant dealer's marketplace participant identifier would be considered to be a DEA order. We would still consider it to be a DEA order, even if the participant dealer's filters vary the destination of the order for regulatory purposes.
6. Provision of Direct Electronic Access (1) Only a participant dealer may provide direct electronic access. (2) A participant dealer may not provide direct electronic access to a registrant, unless the registrant is: (a) a participant dealer; or (b) a portfolio manager.	**Section 6(2)** Prohibition on EMDs to use DEA The majority view was not supportive of the proposal to limit the use of DEA by registrants to only participant dealers or portfolio managers. These commenters expressed the view that exempt market dealers (EMDs) should also be able to use DEA and asked the CSA to reconsider this provision. One commenter noted that it seemed inconsistent to allow unregistered firms or individuals to use DEA but not an EMD and that if the CSA wishes to take the position that UMIR rules must directly apply, then the CSA must exclude all non-IIROC firms or individuals as DEA clients – not just EMDs. Another commenter explained that this requirement could be circumvented by an EMD establishing an unregistered affiliate to whom access could be granted or by simply establishing an electronic link which does not fall within the definition of direct electronic access. It was also cited that the scope of the regulation should be specifically confined to certain circumstances where regulatory arbitrage is a concern, as broader application will curtail legitimate and important transactions.	We continue to be of the view that EMDs conducting brokerage activities that are similar to the activity of investment dealers should be subject to UMIR in order to lessen the incentive for regulatory arbitrage. Due to this overarching concern, we do not think it is appropriate to allow EMDs to trade using DEA. CSA registration staff are also examining policy issues related to firms that are registered as EMDs (See CSA Staff Notice 31-331 and IIROC Notice 12-0217). CSA registration staff are also examining policy issues related to firms that are registered as EMDs.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
	Commenters stated that prohibiting EMDs from using DEA could result in: • forcing EMDs to submit orders using non-DEA methods which would create added latency risk and less liquidity in Canadian marketplaces; • EMDs using a foreign broker that is not registered as an EMD or use other investment dealer firms; • restricting Canadian institutional customers' access to various other types of services, including EMD services; • increased disharmony between requirements for EMDs and non-EMDs; • increased confusion and a negative impact on Canada's equity markets; • an unintended consequence of denying Canadian institutional investors access to the prime brokerage platforms of foreign broker-dealers.	
	Commenters pointed out that many U.S. broker-dealers are registered in Canada as EMDs in order to facilitate part of their business in Canada and that the Draft Regulation would prevent such U.S. broker-dealers from being DEA clients. A commenter also mentioned that the resources needed for a U.S. broker-dealer to institute a Canadian subsidiary and acquire IIROC membership to become an investment dealer would be significant and may outweigh the benefits of doing so.	The Draft Amendments would clarify in the Policy Statement that a foreign dealer that is also registered as an exempt market dealer is eligible for DEA provided that it only uses DEA when acting in its capacity as a foreign dealer and not in its capacity as an exempt market dealer.
	With respect to section 6(2), one commenter suggested the use of a broader term than "portfolio manager" would be beneficial as other categories of buy-side registrants may be created in the future.	We are of the view that using a defined term such as "portfolio manager" provides specificity and clarity. If new registration categories are created in the future, we will consider whether it would be appropriate to add these new categories to Regulation 23-103.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
	Another commenter noted that use of the term “registrant” may be problematic in that the term is defined to include a “person registered or required to be registered” and creates ambiguity as to whether a person that is relying upon a registration exemption is intended to be caught when the term “registrant” is used.	We are of the view that a person that is required to be registered would be caught by the use of the term “registrant” and would not be able to use DEA unless it is registered as a portfolio manager or restricted portfolio manager. If such an entity wishes to use DEA, it may apply for an exemption from this proposed requirement.
	Dual Registration of PM and EMD Certain commenters noted that section 6(2) would result in an odd situation for an entity registered both as a portfolio manager and EMD since it would be able to trade as a discretionary adviser but would not be able to use DEA when it acts as an EMD.	We have proposed clarification in the Policy Statement that a portfolio manager or a restricted portfolio manager that is also registered as an EMD may continue to use DEA in its capacity as a portfolio manager or a restricted portfolio manager but not in its capacity as an EMD.
	Individual Investors Using DEA The majority view of commenters is that individuals should be permitted to use DEA when they have adequate knowledge, experience and financial resources and that it should be left to participating dealers to determine whether or not an individual should be granted DEA. One commenter was of the view that while standards applicable to individual DEA clients may need to be higher in certain regards, the language in the regulation and policy statement seems to imply that the standards may need to be higher in all regards which would unduly disadvantage individual clients in favour of institutional clients. One other commenter was not supportive of providing DEA to individuals. Its view was that this would further complicate the regulatory process around the provision of DEA and would open the possibility of currently registered individuals, such as “pro-traders”, relinquishing their registration status in favour of DEA in an attempt to transfer ultimate regulatory responsibility	The Policy Statement would state that there are circumstances where individuals are sophisticated and have access to the necessary technology to use DEA. In these cases, it is up to the participant dealer offering DEA to determine the appropriate standards required to ensure it is not exposed to undue risk in providing DEA to an individual.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
	to the dealer providing DEA and away from themselves.	
7. Standards for DEA Clients (1) Before granting direct electronic access to a client, a participant dealer must: (a) establish, maintain and apply appropriate standards for direct electronic access; and (b) assess and document whether each client meets the standards established by the participant dealer for direct electronic access. (2) The standards established by the participant dealer pursuant to subsection (1) must include that: (a) the client has appropriate resources to meet any financial obligations that may result from the use of direct electronic access by that client; (b) the client has appropriate arrangements in place to ensure that all personnel using direct electronic access on behalf of the client have knowledge of and proficiency in the use of the order entry system that the client will use; (c) the client has knowledge of and has the ability to comply with all applicable marketplace and regulatory requirements; and (d) the client has in place adequate arrangements to monitor the entry of orders through direct electronic access. (3) A participant dealer must confirm with the DEA client, at least annually, that the DEA client continues to meet the standards established by the participant dealer, including those set out in subsection (2).	Commenters expressed support for using the proposed standards rather than using an eligible client list. One commenter noted however that there may be confusion for investors who use more than one dealer with different standards and that there may be pressure on dealers to adopt the lowest standards used by other participant dealers.	We agree that the proposed standards, which are in line with global standards, are the most appropriate for the Canadian markets.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
8. Written Agreement Prior to granting direct electronic access to a client, a participant dealer must enter into a written agreement with the client that provides that as a DEA client: (a) the DEA client's trading activity will comply with marketplace and regulatory requirements; (b) the DEA client's trading activity will comply with the product limits or credit or other financial limits specified by the participant dealer; (c) the DEA client will maintain all technology facilitating direct electronic access in an electronically and physically secure manner and will prohibit personnel, other than those authorized by the participant dealer, to use the direct electronic access granted; (d) the DEA client will fully cooperate with the participant dealer in connection with any investigation or proceeding by any marketplace, regulation services provider, securities regulatory authority or law enforcement agency with respect to trading conducted pursuant to the direct electronic access granted, including, upon request by the participant dealer, providing access to such information to the marketplace, regulation services provider, securities regulatory authority or law enforcement agency that is necessary for the purposes of any such investigation or proceeding; (e) the DEA client acknowledges that the participant dealer may (i) reject an order; (ii) vary, correct or cancel an order entered on a marketplace; and (iii) discontinue accepting orders from the DEA client; (f) the DEA client will immediately inform the participant	In general, commenters agreed with the proposal for a written agreement however one commenter suggested that the prescriptive elements be moved to the Policy Statement as guidance. One commenter asked the CSA to reconsider if a written agreement is essential as incorporating new provisions into current agreements would be burdensome. **Section 8(d)** A couple of commenters noted that providing access to information deemed necessary for an investigation may create breaches in privacy law and breaches of foreign laws. **Section 8(e)** One commenter expressed concern with allowing a participant dealer to vary or cancel any trade made by the client for any reason and suggested that changes to orders not be a required term of the agreement but rather be optional and subject to negotiation between the parties.	The CSA are of the view that the prescriptive elements of the written agreement are important in assisting a participant dealer to address its risks associated with providing direct electronic access. As a result these elements continue to be included in the Draft Amendments. Our research indicates that this provision does not create breaches in privacy law and is very unlikely to breach foreign law. DEA providers are currently able to cancel or vary any trade made by their clients under the written agreement prescribed under TSX Policy 2-502 and other marketplaces have adopted similar provisions. We are of the view that under certain circumstances it may be necessary for a participant dealer to cancel or vary an order to ensure that it

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
dealer if it fails or reasonably expects not to meet the standards set by the participant dealer;		is able to manage the risks to its business. As a result, we have maintained this requirement in the Draft Amendments.
	Section 8(g)	
(g) when trading for the accounts of its clients, pursuant to subsection 11(2), the DEA client will ensure that the orders of its clients will flow through the systems of the DEA client and will be subject to appropriate risk management and supervisory controls, policies and procedures;	One commenter suggested that the standard to "ensure" that the orders of its clients will flow through the systems of the DEA client and will be subject to appropriate risk management and supervisory controls, policies and procedures should be changed to a "reasonability" standard.	The proposed provision now states that the client will "take all reasonable steps to ensure that the orders of its clients will flow through the systems of the client and will be subject to reasonable risk management and supervisory controls, policies and procedures".
(h) the DEA client will not trade for the accounts of its clients, pursuant to subsection 11(2), unless (i) such clients meet the standards established by the participant dealer pursuant to section 7; and (ii) a written agreement is in place between the DEA client and its clients that sets out the terms of the access provided.		
	Addition of other provisions	
	Some commenters suggested including additional provisions in the proposed written agreement including: • the client is to provide a list of employees who are authorized to use the DEA identifier and update this list as necessary • an undertaking by the DEA client that the DEA client identifier will be used exclusively by the DEA client and its authorized employees.	We have included an additional provision in the written agreement that requires the DEA client to inform the participant dealer in writing of all individuals acting on the client's behalf that it has authorized to use its DEA client identifier to the participant dealer and to update this list as necessary. We note that a participant dealer is also able to introduce additional requirements or provisions in the written agreement it feels are

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
	Another commenter suggested that an agreement among the DEA client, participating dealer and marketplace be required to clearly set out the roles and responsibilities of each party in the sponsored client relationship and formalize the commitments in place from the client to the dealer and the dealer to the marketplace.	necessary to manage its specific risks. We are of the view that a marketplace may require such a tri-party agreement under subsection 7(2) of the Regulation if it deems this to be necessary to manage the risks of DEA trading on its platform.
9. Training of DEA Clients (1) Prior to granting direct electronic access to a client, and as necessary after direct electronic access is granted, a participant dealer must satisfy itself that the client has adequate knowledge of applicable marketplace and regulatory requirements and the standards established pursuant to section 7. (2) If a participant dealer concludes that a client does not have adequate knowledge with respect to applicable marketplace and regulatory requirements, or standards established pursuant to section 7, the participant dealer must ensure the necessary training is provided to the client prior to granting direct electronic access to the client. (3) A participant dealer must ensure that the DEA client receives any relevant changes and updates to applicable marketplace and regulatory requirements or standards established pursuant to section 7.	One commenter requested clarification on the CSA's expectations for establishing if a DEA client's knowledge is adequate and the type of training to be provided to DEA clients. This commenter also asked the CSA to reconsider a statement in the Policy Statement that asserts that dealers may need to "require clients to have the same training required of marketplace participants" given the filtering of the DEA client's trading.	The Policy Statement would clarify that what constitutes "reasonable knowledge" will depend on the particular client's trading activity and the resulting risks presented by each specific client. The training, must at a minimum, enable the client to understand the applicable marketplace and regulatory requirements and how trading on the marketplace system occurs. The Draft Amendments do not impose a requirement that DEA clients have the same training as marketplace participants, but we are of the view that the participant dealer, in managing its risks with respect to providing DEA, may determine this level of knowledge is needed for its DEA clients.

Text of Proposed Provisions	Summary of Comments	CSA Response to Comment
11. Trading by DEA Clients (1) Except as provided in subsection (2), a participant dealer must only provide direct electronic access to a client that is trading for its own account. (2) When using direct electronic access, the following DEA clients may trade for their own account or for the accounts of their clients: (a) a participant dealer; (b) a portfolio manager; and (c) an entity that is authorized in a category analogous to the entities referred to in paragraphs (a) and (b) in a foreign jurisdiction that is a signatory to the International Organization of Securities Commissions' Multilateral Memorandum of Understanding. (3) Where a DEA client is using direct electronic access to trade for the accounts of its clients, pursuant to subsection (2), the clients' orders must flow through the systems of the DEA client before being entered on a marketplace directly or indirectly through a participant dealer. (4) A participant dealer must ensure that where a DEA client is trading for the accounts of its clients, the DEA client has established and maintains appropriate risk management and supervisory controls, policies and procedures. (5) A DEA client must not provide access to or pass on its direct electronic access to another person.	**11(2)** Some commenters expressed the view that this section is too limiting. Another commenter urged the CSA to have discussions with marketplace participants that have established global affiliate networks to ensure that existing systems with adequate risk management controls are not unintentionally excluded in this proposed section	We think that the restriction proposed in this section is necessary in order to manage the risks that DEA trading may pose.
13. DEA Client Identifiers A marketplace must not permit a marketplace participant to provide direct electronic access unless the marketplace's systems support the use of DEA client identifiers.	One commenter pointed out that the language in this section may go beyond current practices and therefore may be more than a codification of current marketplace practices. Specifically, this commenter noted that there is no existing order marker or tag used to identify DMA clients, rather the participants of the TSX and TSXV provide these exchanges with a list of trader IDs through which direct market access clients send order flow.	This requirement would codify the current practice of assigning a unique ID to a DEA client and providing this unique identifier to the regulation services provider or marketplace conducting its own market regulation.

REGULATION TO AMEND REGULATION 23-103 RESPECTING ELECTRONIC TRADING

Securities Act
(R.S.Q., c. V-1.1, s. 331.1, par. (11), (32) and (34))

1. Regulation 23-103 respecting Electronic Trading is amended by replacing the title with the following:

"**REGULATION 23-103 RESPECTING ELECTRONIC TRADING AND DIRECT ELECTRONIC ACCESS TO MARKETPLACES**".

2. Section 1.1 of the Regulation is amended:

(1) by inserting, after the definition of the expression "automated order system", the following:

""direct electronic access" means the access provided by a person to a client that permits the client to electronically transmit an order relating to a security to a marketplace, using the person's marketplace participant identifier,

(a) through the person's systems for automatic onward transmission to a marketplace; or

(b) directly to the marketplace without being electronically transmitted through the person's systems;

"DEA client" means a client that is granted direct electronic access by a participant dealer;

"DEA client identifier" means a unique client identifier assigned to a DEA client by a participant dealer;";

(2) by replacing, in the French text of the definition of the expression "marketplace and regulatory requirements", the word "règlementation" with the word "réglementation";

(3) by inserting, after the definition of the expression "marketplace and regulatory requirements", the following:

"marketplace participant identifier" means the unique identifier assigned to a marketplace participant to access a marketplace; and".

3. Section 3 of the Regulation is amended:

(1) by replacing, in the French text of subparagraph (a) of paragraph (1), the words "au marché" with the words "aux marchés";

(2) by replacing, in subparagraph (a) of paragraph (2), ", and" with "; and";

(3) in paragraph (3):

(a) by replacing, at the end of subparagraph (i) of subparagraph (a), "," with ";";

(b) in the French text of subparagraph (b):

(i) by replacing, in subparagraph (ii), the word "octroie" with the word "accorde";

(ii) by replacing, in subparagraph (iv), the words “transmis au marché” with the word “transmis”, and the word “octroie” with the word “accorde”;

(c) by replacing, in the French text of subparagraph (c), the word “octroie” with the word “accorde”;

(d) by replacing, in the French text of subparagraph (d), the words “au marché qu’il octroie” with the words “à un marché qu’il accorde”;

(4) by replacing, in the French text of paragraph (4), the words “doit être” with the word “est”, and the word “octroie” with the word “accorde”;

(5) by replacing, in the French text of paragraph (5), the words “ajuste de façon directe et exclusive” with the words “modifie directement et exclusivement”;

(6) by replacing the French text of subparagraph (b) of paragraphs 6 and 7 with the following:

“*b)* il documente les lacunes dans la convenance et l’efficacité de ces contrôles, politiques et procédures et les corrige rapidement.”.

4. Section 4 of the Regulation is amended, in the French text:

(1) by replacing, in the title, the words “**d’ajuster**” with the words “**de modifier**”.

(2) by replacing the part preceding subparagraph (a) with the following:

“Malgré le paragraphe 5 de l’article 3, le courtier participant peut, pour des motifs raisonnables, autoriser un courtier en placement à établir ou modifier en son nom un contrôle, une politique ou une procédure en particulier concernant la gestion des risques ou la surveillance prévu au paragraphe 1 de l’article 3, si les conditions suivantes sont réunies :”;

(3) by replacing, in subparagraph (a), the word “client” with the words “client ultime”, and the words “et peut ainsi établir ou ajuster le contrôle, la politique ou la procédure de manière plus efficace” with the words “et qu’il peut ainsi établir ou modifier le contrôle, la politique ou la procédure plus efficacement”;

(4) by replacing, in subparagraph (b), the words “l’ajuster” with the words “le modifier”;

(5) by replacing, in subparagraph (c), the words “l’ajustement” with the words “la modification” and the words “l’ajuster” with the words “le modifier”;

(6) in subparagraph (d):

(a) by replacing, in subparagraph (i), the words “l’ajustement” with the words “la modification”;

(b) by replacing subparagraph (ii) with the following:

“*ii)* il documente les lacunes dans la convenance et l’efficacité de l’établissement ou de la modification et veille à les faire corriger rapidement;”;

(7) by replacing, in subparagraph (e), the word “client” with the words “client ultime”.

5. The Regulation is amended by inserting, after Part 2, the following:

“**PART 2.1 REQUIREMENTS APPLICABLE TO PARTICIPANT DEALERS PROVIDING DIRECT ELECTRONIC ACCESS**

“**4.1. Application of this Part**

This Part does not apply to a participant dealer if the participant dealer complies with similar requirements established by

(a) a regulation services provider;

(b) a recognized exchange that directly monitors the conduct of its members and enforces requirements set under subsection 7.1(1) of Regulation 23-101 respecting Trading Rules; or

(c) a recognized quotation and trade reporting system that directly monitors the conduct of its users and enforces requirements set under subsection 7.3(1) of Regulation 23-101 respecting Trading Rules.

“**4.2. Provision of Direct Electronic Access**

(1) A person must not provide direct electronic access unless it is a participant dealer.

(2) A participant dealer must not provide direct electronic access to a registrant unless the registrant is

(a) a portfolio manager; or

(b) a restricted portfolio manager.

“**4.3. Standards for DEA Clients**

(1) A participant dealer must not provide direct electronic access to a client unless it

(a) has established, maintains and applies reasonable standards for direct electronic access; and

(b) assesses and documents whether each client meets the standards established by the participant dealer for direct electronic access.

(2) The standards established by the participant dealer under subsection (1) must include the following:

(a) a client must not have direct electronic access unless the client has sufficient resources to meet any financial obligations that may result from the use of direct electronic access by that client,

(b) a client must not have direct electronic access unless the client has reasonable arrangements in place to ensure that all individuals using direct electronic access on behalf of the client have reasonable knowledge of and proficiency in the use of the order entry system that facilitates the direct electronic access,

(c) a client must not have direct electronic access unless the client has reasonable knowledge of and the ability to comply with all applicable marketplace and regulatory requirements, and

(d) a client must not have direct electronic access unless the client has reasonable arrangements in place to monitor the entry of orders through direct electronic access.

(3) A participant dealer must confirm, at least annually with the DEA client, that the DEA client continues to meet the standards established by the participant dealer, including for greater certainty, those set out in this section.

"**4.4. Written Agreement**

A participant dealer must not provide direct electronic access to a client unless the client has entered into a written agreement with the participant dealer that provides that,

(a) in its capacity as a DEA client,

(i) the client's trading activity will comply with marketplace and regulatory requirements;

(ii) the client's trading activity will comply with the product limits and credit or other financial limits specified by the participant dealer;

(iii) the client will take all reasonable steps to prevent unauthorized access to the technology that facilitates direct electronic access and will not permit any person other than those authorized by the participant dealer, to use the direct electronic access provided by the participant dealer;

(iv) the client will fully cooperate with the participant dealer in connection with any investigation or proceeding by any marketplace or regulation services provider with respect to trading conducted pursuant to the direct electronic access provided, including, upon request by the participant dealer, providing access to the information to the marketplace or regulation services provider that is necessary for the purposes of the investigation or proceeding;

(v) the client will immediately inform the participant dealer if it fails or expects not to meet the standards set by the participant dealer;

(vi) when trading for the accounts of its clients, under subsection 4.7(2), the client will take all reasonable steps to ensure that the orders of its clients will flow through the systems of the client and will be subject to reasonable risk management and supervisory controls, policies and procedures;

(vii) the client will inform the participant dealer in writing of all individuals acting on the client's behalf that it has authorized to use its DEA client identifier and will immediately, in writing, inform the participant dealer if

(A) an additional individual has been granted authority to use the DEA client identifier; or

(B) the authority of an individual to use the DEA client identifier has been removed or the individual has been terminated; and

(b) the participant dealer has the authority to, without prior notice

(i) reject any order;

(ii) vary, correct or cancel any order entered on a marketplace; and

(iii) discontinue accepting orders from the DEA client.

"**4.5. Training of DEA Clients**

(1) A participant dealer must not allow a client to have, or continue to have, direct electronic access unless the participant dealer is satisfied that the client has reasonable knowledge of applicable marketplace and regulatory requirements and the standards established by the participant dealer under section 4.3.

(2) A participant dealer must ensure that a DEA client receives any relevant amendments to applicable marketplace and regulatory requirements or changes or updates to the standards established by the participant dealer under section 4.3.

"**4.6. DEA Client Identifier**

(1) Upon providing direct electronic access to a DEA client, a participant dealer must assign to the client a DEA client identifier in the form and manner required by

(a) a regulation services provider;

(b) a recognized exchange that directly monitors the conduct of its members and enforces requirements set under subsection 7.1(1) of Regulation 23-101 respecting Trading Rules; or

(c) a recognized quotation and trade reporting system that directly monitors the conduct of its users and enforces requirements set under subsection 7.3(1) of Regulation 23-101 respecting Trading Rules.

(2) A participant dealer that assigns a DEA client identifier under subsection (1) must immediately provide the DEA client identifier to each marketplace to which the DEA client has direct electronic access through the participant dealer.

(3) A participant dealer that assigns a DEA client identifier under subsection (1) must immediately provide the DEA client's name and its associated DEA client identifier to:

(a) all regulation services providers monitoring trading on a marketplace to which the DEA client has access through the participant dealer;

(b) any recognized exchange or recognized quotation and trade reporting system that directly monitors the conduct of its members or users and enforces requirements set under subsection 7.1(1) or 7.3(1) of Regulation 23-101 respecting Trading Rules and to which the DEA client has access through the participant dealer; and

(c) any exchange or quotation and trade reporting system that is recognized for the purposes of this Instrument and that directly monitors the conduct of its members or users and enforces requirements set under subsection 7.1(1) or 7.3(1) of Regulation 23-101 respecting Trading Rules and to which the DEA client has access through the participant dealer.

(4) A participant dealer must ensure that an order entered by a DEA client using direct electronic access provided by the participant dealer includes the appropriate DEA client identifier.

(5) If a client ceases to be a DEA client, the participant dealer must promptly inform:

(a) all regulation services providers monitoring trading on a marketplace to which the DEA client had access through the participant dealer;

(b) any recognized exchange or recognized quotation and trade reporting system that directly monitors the conduct of its members or users and enforces requirements set under section 7.1(1) or 7.3(1) of Regulation 23-101 respecting Trading Rules and to which the DEA client had access through the participant dealer; and

(c) any exchange or quotation and trade reporting system that is recognized for the purposes of this Instrument and that directly monitors the conduct of its members or users and enforces requirements set under subsection 7.1(1) or 7.3(1) of Regulation 23-101 respecting Trading Rules and to which the DEA client had access through the participant dealer.

"**4.7. Trading by DEA Clients**

(1) A participant dealer must not provide direct electronic access to a DEA client that is trading for the account of another person.

(2) Despite subsection (1), when using direct electronic access, the following DEA clients may trade for the accounts of their clients:

(a) a portfolio manager;

(b) a restricted portfolio manager;

(c) a person that is registered in a category analogous to the entities referred to in paragraphs (a) or (b) in a foreign jurisdiction that is a signatory to the International Organization of Securities Commissions' Multilateral Memorandum of Understanding.

(3) If a DEA client is using direct electronic access to trade for the account of a client, as permitted by subsection (2), the DEA client must ensure that its client's orders flow through the systems of the DEA client before being entered on a marketplace.

(4) A participant dealer must ensure that when a DEA client is trading for the account of its client using direct electronic access, the DEA client has established and maintains reasonable risk management and supervisory controls, policies and procedures.

(5) A DEA client must not provide access to or pass on its direct electronic access to another person other than the individuals authorized under paragraph 4.4(a)(vii).".

6. Section 5 of the Regulation is amended, in the French text of paragraph (3):

(1) by replacing, in subparagraph (b), the words "par année" with the words "l'an";

(2) by replacing, in subparagraph (c), the words "de contrôles" with the words "des contrôles" and the words "immédiatement de faire" with the words "de faire immédiatement".

7. Section 7 of the Regulation is amended, in the French text:

(1) by replacing, in paragraph (1), the words "n'octroie" with the words "n'accorde";

(2) by replacing, in subparagraph (c) of paragraph (2), the words "visés au" with the words "mis en œuvre en vertu du".

8. Section 9 of the Regulation is amended, in the French text:

(1) by replacing, in paragraph (1), the words "n'octroie" with the words "n'accorde";

(2) by replacing, subparagraph (b) of paragraph (2), the words "des parties à l'opération, les deux parties" with the words "des deux parties à l'opération, celles-ci".

9. The Regulation is amended by inserting, after section 9, the following:

"**9.1. Client Identifiers**

(1) A marketplace must not permit a marketplace participant to provide direct electronic access to a person unless the marketplace's systems support the use of DEA client identifiers.".

10. This Regulation comes into force on (*indicate the date of coming into force of this Regulation*).

POLICY STATEMENT TO REGULATION 23-103 RESPECTING ELECTRONIC TRADING AND DIRECT ELECTRONIC ACCESS TO MARKETPLACES

PART 1 GENERAL COMMENTS

1.1. Introduction

(1) ***Purpose of Regulation 23-103***

The purpose of *Regulation 23-103 respecting Electronic Trading and Direct Electronic Access to Marketplaces* (Regulation 23-103) is to address areas of concern and risks brought about by electronic trading and direct electronic access (DEA). The increased speed and automation of trading on marketplaces give rise to various risks, including credit risk and market integrity risk. To protect marketplace participants from harm and to ensure continuing market integrity, these risks need to be reasonably and effectively controlled and monitored.

In the view of the Canadian Securities Administrators (CSA or we), marketplace participants should bear primary responsibility for ensuring that these risks are reasonably and effectively controlled and monitored. This responsibility applies to orders that are entered electronically by the marketplace participant itself, as well as orders from clients using the participant dealer's marketplace participant identifier.

This responsibility includes both financial and regulatory obligations. This view is premised on the fact that it is the marketplace participant that makes the decision to engage in trading or provide marketplace access to a client. However, the marketplaces also have some responsibilities to manage risks to the market.

Regulation 23-103 is meant to address risks associated with electronic trading on a marketplace with a key focus on the gatekeeping function of the executing broker. However, a clearing broker also bears financial and regulatory risks associated with providing clearing services. Under *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* (Regulation 31-103) a dealer must manage the risks associated with its business in accordance with prudent business practices. As part of that obligation, we expect a clearing dealer to have in place effective systems and controls to properly manage its risks.

Regulation 23-103 also provides a minimum framework for the provision of DEA; however we note that each marketplace has the discretion to determine whether to allow DEA and to impose stricter standards regarding the provision of DEA.

(2) ***Scope of Regulation 23-103***

Regulation 23-103 applies to the electronic trading of securities on marketplaces. In Alberta and British Columbia, the term "security" when used in Regulation 23-103 includes an option that is an exchange contract but does not include a futures contract. In Ontario, the term "security" when used in Regulation 23-103, does not include a commodity futures contract or a commodity futures option that is not traded on a commodity futures exchange registered with or recognized by the Commission under the Commodity Futures Act or the form of which is not accepted by the Director under the Commodity Futures Act. In Québec, the term "security" when used in Regulation 23-103, includes a standardized derivative as this notion is defined in the Derivatives Act.

(3) ***Purpose of Policy Statement***

This Policy Statement sets out how the CSA interpret or apply the provisions of Regulation 23-103 and related securities legislation.

Except for Part 1, the numbering of Parts and sections in this Policy Statement correspond to the numbering in Regulation 23-103. Any general guidance for a Part appears immediately after the Part name. Any specific guidance on sections in Regulation 23-103 follows any general guidance. If there is no guidance for a Part or section, the numbering in this Policy Statement will skip to the next provision that does have guidance.

All references in this Policy Statement to Parts and sections are to Regulation 23-103**,** unless otherwise noted.

1.2. Definitions

Unless defined in Regulation 23-103**,** terms used in Regulation 23-103 and in this Policy Statement have the meaning given to them in the securities legislation of each jurisdiction, in *Regulation 14-101 respecting Definitions*, *Regulation 21-101 respecting Marketplace Operation* (Regulation 21-101), or Regulation 31-103.

(1) ***Automated order systems***

Automated order systems encompass both hardware and software used to generate or electronically transmit orders on a pre-determined basis and would include smart order routers and trading algorithms that are used by marketplace participants, offered by marketplace participants to clients or developed or used by clients.

(2) ***Direct electronic access***

Section 1 defines "direct electronic access" as the access provided by a person to a client that permits the client to electronically transmit an order relating to a security to a marketplace, using the person's marketplace participant identifier either through the person's systems for automatic onward transmission to a marketplace or directly to a marketplace without being electronically transmitted through the person's systems.

While the term "person" is used in the definition of DEA, under subsection 4.2(1), only a participant dealer may provide DEA.

The CSA view a DEA order as including an order that is generated by an automated order system used by a DEA client if the DEA client determines the specified marketplace to which the order is to be sent and if the order is transmitted using the participant dealer's marketplace participant identifier. We hold this view regardless of whether or not the DEA client is using an automated order system that is offered by the participant dealer. We note that a DEA client's routing decisions may be varied for regulatory purposes by a participant dealer when an order passes through the participant dealer's system, for example to comply with the order protection rule or with the risk management requirements of Regulation 23-103, but we still consider the order to be a DEA order.

This definition does not capture orders entered using an order execution service or other electronic access arrangements in which a client uses the website of a dealer to enter orders since these services and arrangements do not permit the client to enter orders using a participant dealer's marketplace participant identifier.

(3) ***DEA client identifier***

Regulation 23-103 requires each DEA client to have a unique identifier in order to track orders originating from that DEA client. A participant dealer is responsible for assigning the DEA client identifier under subsection 4.6(1) and for ensuring that every order entered by a DEA client using DEA includes the appropriate DEA client identifier under subsection 4.6(4). Following current industry practice, we expect the participant dealer will collaborate with the marketplace with respect to determining the necessary identifiers.

(4) ***Marketplace participant identifier***

A marketplace participant identifier is the unique identifier assigned to the marketplace participant for trading purposes. The assignment of this identifier is co-ordinated with a regulation services provider of the marketplace, where applicable. We expect a marketplace participant to use its marketplace participant identifier across all marketplaces of which it is a member, user or subscriber.

PART 2 REQUIREMENTS APPLICABLE TO MARKETPLACE PARTICIPANTS

3. Risk management and supervisory controls, policies and procedures

(1) ***Regulation 31-103 requirements***

For marketplace participants that are registered firms, section 11.1 of Regulation 31-103 requires the registered firm to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to: (a) provide reasonable assurance that the registered firm and each individual acting on its behalf complies with securities legislation; and (b) manage the risks associated with its business in accordance with prudent business practices. Section 3 of Regulation 23-103 builds on the obligations outlined in section 11.1 of Regulation 31-103. The CSA have included requirements in Regulation 23-103 for all marketplace participants that conduct trading on a marketplace to have risk management and supervisory controls, policies and procedures that are reasonably designed to manage their risks in accordance with prudent business practices. A marketplace participant must apply its risk management and supervisory controls, policies and procedures to all trading conducted under its marketplace participant identifier including trading conducted by a DEA client.

What would be considered to be "reasonably designed" in this context is tied to the risks associated with electronic trading that the marketplace participant is willing to bear and what is necessary to manage that risk in accordance with prudent business practices.

These requirements provide greater specificity with respect to the expectations surrounding controls, policies and procedures relating to electronic trading. The requirements apply to all marketplace participants, not just those that are registered firms.

(2) ***Documentation of risk management and supervisory controls, policies and procedures***

Paragraph 3(1)(b) requires a marketplace participant to record its policies and procedures and maintain a copy of its risk management and supervisory controls in written form. This includes a narrative description of any electronic controls implemented by the marketplace participant as well as their functions.

We note that the risk management and supervisory controls, policies and procedures related to the trading of unlisted, government and corporate debt may not be the same as those related to the trading of equity securities due to the differences in the nature of trading of these types of securities. Different marketplace models such as a request for quote, negotiation system, or continuous auction market may require different risk management and supervisory controls, policies and procedures in order to appropriately address the varying levels of diverse risks these different marketplace models can pose to our markets.

A registered firm's obligation to maintain its risk management and supervisory controls in written form under paragraph 3(1)(b) includes retaining these documents and builds on a registered firm's obligation in Regulation 31-103 to retain its books and records. We expect a non-registered marketplace participant to retain these documents as part of its obligation under paragraph 3(1)(b) to maintain a description of its risk management and supervisory controls in written form.

(3) ***Clients that also maintain risk management controls***

We are aware that a client that is not a registered dealer may maintain its own risk management controls. However, part of the intent of Regulation 23-103's risk management and supervisory controls, policies and procedures is to require a participant dealer to manage its risks associated with electronic trading and to protect the participant dealer under whose marketplace participant identifier an order is being entered. Consequently, a participant dealer must maintain reasonably designed risk management and supervisory controls, policies and procedures regardless of whether its clients maintain their own controls. It is not appropriate for a participant dealer to rely on a client's risk management controls, as the participant dealer would not be able to ensure the sufficiency of the client's controls, nor would the controls be tailored to the particular needs of the participant dealer.

(4) ***Minimum risk management and supervisory controls, policies and procedures***

Subsection 3(2) sets out the minimum elements of the risk management and supervisory controls, policies and procedures that must be addressed and documented by each marketplace participant. Automated pre-trade controls include an examination of the order before it is entered on a marketplace and the monitoring of entered orders whether executed or not. The marketplace participant should assess, document and implement any additional risk management and supervisory controls, policies and procedures that it determines are necessary to manage the marketplace participant's financial exposure and to ensure compliance with applicable marketplace and regulatory requirements.

With respect to regular post-trade monitoring, it is expected that the regularity of this monitoring will be conducted commensurate with the marketplace participant's determination of the order flow it is handling. At a minimum, an end of day check is expected.

(5) ***Pre-determined credit or capital thresholds***

A marketplace participant can establish pre-determined credit thresholds by setting lending limits for a client and establish pre-determined capital thresholds by setting limits on the financial exposure that can be created by orders entered or executed on a marketplace under its marketplace participant identifier. The pre-determined credit or capital thresholds referenced in paragraph 3(3)(a) may be set based on different criteria, such as per order, trade account or other criteria, including overall trading strategy, or using a combination of these factors as required in the circumstances.

For example, a participant dealer that sets a credit limit for a client with marketplace access provided by the participant dealer could impose that credit limit by setting sub-limits applied at each marketplace to which the participant dealer provides access that together equal the total credit limit. A participant dealer may also consider whether to establish credit or capital thresholds based on sector, security or other relevant factors. In order to address the financial exposure that might result from rapid order entry, a participant dealer may also consider measuring compliance with set credit or capital thresholds on the basis of orders entered rather than executions obtained.

We note that different thresholds may be set for the marketplace participant's own order flow (including both proprietary and client order flow) and that of a client with marketplace access provided by the marketplace participant, if appropriate.

(6) ***Compliance with applicable marketplace and regulatory requirements***

The CSA expect marketplace participants to prevent the entry of orders that do not comply with all applicable marketplace and regulatory requirements that must be satisfied on a pre-trade basis where possible. Specifically, marketplace and regulatory requirements that must be satisfied on a pre-order entry basis are those requirements that can effectively be complied with only before an order is entered on a marketplace, including: (i) conditions

that must be satisfied under *Regulation 23-101 respecting Trading Rules* (Regulation 23-101) before an order can be marked a "directed-action order", (ii) marketplace requirements applicable to particular order types and (iii) compliance with trading halts. This requirement does not impose new substantive regulatory requirements on the marketplace participant. Rather it establishes that marketplace participants must have appropriate mechanisms in place that are reasonably designed to effectively comply with their existing regulatory obligations on a pre-trade basis in an automated, high-speed trading environment.

(7) ***Order and trade information***

Subparagraph 3(3)(b)(iv) requires the risk management and supervisory controls, policies and procedures to be reasonably designed to ensure that the compliance staff of the marketplace participant receives immediate order and trade information. This will require the marketplace participant to ensure that it has the capability to view trading information in real-time or to receive immediate order and trade information from the marketplace, such as through a drop copy.

This requirement will help the marketplace participant fulfill its obligations under subsection 3(1) with respect to establishing and implementing reasonably designed risk management and supervisory controls, policies and procedures that manage its risks associated with access to marketplaces.

This provision does not prescribe that a marketplace participant carry out compliance monitoring in real-time. There are instances however, when automated, real-time monitoring should be considered, such as when an automated order system is used to generate orders. It is up to the marketplace participant to determine, based on the risk that the order flow poses to the marketplace participant, the appropriate timing for compliance monitoring. However, our view is that it is important that a marketplace participant have the necessary tools in place to facilitate order and trade monitoring as part of the marketplace participant's risk management and supervisory controls, policies and procedures.

(8) ***Direct and exclusive control over setting and adjusting of risk management and supervisory controls, policies and procedures***

Subsection 3(5) specifies that a marketplace participant must directly and exclusively set and adjust its risk management and supervisory controls, policies and procedures. With respect to exclusive control, we expect that no person, other than the marketplace participant, will be able to set and adjust the controls, policies and procedures. With respect to direct control, a marketplace participant must not rely on a third party in order to perform the actual setting and adjusting of its controls, policies and procedures.

A marketplace participant can use technology of third parties, including that of marketplaces, as long as the marketplace participant, whether a registered dealer or institutional investor, is able to directly and exclusively set and adjust its supervisory and risk management controls, policies and procedures.

Section 4 provides a limited exception to the requirement in subsection 3(5) in that a participant dealer may , on a reasonable basis, and subject to other requirements, authorize an investment dealer to set or adjust a specific risk management or supervisory control, policy or procedure on behalf of the participant dealer.

(9) ***Risk management and supervisory controls, policies and procedures provided by an independent third party***

Under subsection 3(4), a third party providing risk management and supervisory controls, policies or procedures to a marketplace participant must be independent of any client of the marketplace participant. However, an entity affiliated with a participant dealer that is also a client of the participant dealer may provide supervisory and risk management

controls to the participant dealer. In all instances, the participant dealer must directly and exclusively set and adjust its supervisory and risk management controls.

Paragraph 3(7)(a) requires that a marketplace participant must regularly assess and document whether the risk management and supervisory controls, policies and procedures of the third party are effective and otherwise consistent with the provisions of Regulation 23-103 before engaging such services. Reliance on representations of a third party provider is insufficient to meet this assessment requirement. The CSA expect registered firms to be responsible and accountable for all functions that they outsource to a service provider as set out in Part 11 of *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations.*

(10) ***Regular assessment of risk management controls and supervisory policies and procedures***

Subsection 3(6) requires a marketplace participant to regularly assess and document the adequacy and effectiveness of the controls, policies and procedures it is required to establish under subsection 3(1). Under subsection 3(7), the same assessment requirement also applies if a marketplace participant uses the services of a third party to provide risk management or supervisory controls, policies and procedures. A "regular" assessment would constitute, at a minimum, an assessment conducted annually of the controls, policies and procedures and whenever a substantive change is made to the controls, policies and procedures. A marketplace participant should determine whether more frequent assessments are required, depending on the particular circumstances.

A marketplace participant that is a registered firm is expected to retain the documentation of each such assessment as part of its obligation to maintain books and records in Regulation 31-103.

4. Authorization to set or adjust risk management and supervisory controls, policies and procedures

Section 4 is intended to address introducing (originating) and carrying (executing) arrangements or jitney arrangements that involve multiple dealers. In such arrangements, there may be certain controls that are better directed by the originating dealer, since it is the originating dealer that has knowledge of its client and is responsible for suitability and other "know your client" obligations. ~~However, the executing dealer must also have reasonable controls~~The "ultimate client" is expected to be a third party to the originating investment dealer in all instances.

The executing dealer must also have reasonable controls in place to manage the risks it incurs by executing orders for other dealers.

Therefore, section 4 provides that a participant dealer may, on a reasonable basis, authorize an investment dealer to set or adjust a specific risk management or supervisory control, policy or procedure on the participant dealer's behalf by written contract and after a thorough assessment. Our view is that where the originating investment dealer with the direct relationship with the ultimate client has better access than the participant dealer to information relating to the ultimate client, the originating investment dealer may more effectively assess the ultimate client's financial resources and investment objectives.

We also expect that the participant dealer will maintain a written contract with the investment dealer that sets out a description of the specific risk management or supervisory control, policy or procedure and the conditions under which the investment dealer is authorized to set or adjust the control, policy or procedure as part of its books and records obligations set out in Regulation 31-103.

Paragraph 4(d) requires a participant dealer to regularly assess the adequacy and effectiveness of the investment dealer's setting or adjusting of the risk management and supervisory controls, policies and procedures that it performs on the participant dealer's

behalf. We expect that this will include an assessment of the performance of the investment dealer under the written agreement prescribed in paragraph 4(b). A "regular" assessment would constitute, at a minimum, an assessment conducted annually of the controls, policies and procedures and whenever a substantive change is made to the controls, policies or procedures. A marketplace participant should determine whether more frequent assessments are required, depending on the particular circumstances.

Under paragraph 4(e), the participant dealer must provide the compliance staff of the originating investment dealer with immediate order and trade information of the ultimate client. This is to allow the originating investment dealer to monitor trading more effectively and efficiently.

Authorizing an investment dealer to set or adjust a risk management or supervisory control, policy or procedure does not relieve the participant dealer of its obligations under section 3, including the overall responsibility to establish, document, maintain and ensure compliance with risk management and supervisory controls, policies and procedures reasonably designed to manage, in accordance with prudent business practices, the financial, regulatory and other risks associated with marketplace access.

PART ~~3~~ 2.1 REQUIREMENTS APPLICABLE TO PARTICIPANT DEALERS PROVIDING DIRECT ELECTRONIC ACCESS

4.2. Provision of DEA

(1) ***Registration requirement***

Only marketplace participants that meet the definition of "participant dealer" are permitted to provide DEA to clients. Regulation 23-103 defines a participant dealer as a marketplace participant that is an investment dealer. This is due to the fact that providing DEA to a client triggers the registration requirements under applicable Canadian securities legislation.

(2) ***Persons not eligible for DEA***

Subsection 4.2(2) does not allow DEA to be provided to a registrant other than a portfolio manager or a restricted portfolio manager.

Certain registered dealers, such as exempt market dealers, are not eligible for DEA, because the CSA do not want to facilitate regulatory arbitrage with respect to trading. In our view, if a registered dealer wishes to have direct access to marketplaces, then the registered dealer should be a member of the Investment Industry Regulatory Organization of Canada (IIROC) and subject to IIROC rules including the Universal Market Integrity Rules (UMIR) if accessing equity marketplaces.

We note that an exempt market dealer may still trade, however it cannot use DEA in its capacity as an exempt market dealer. A portfolio manager or restricted portfolio manager that is also registered as an exempt market dealer is eligible for DEA if it only uses DEA when acting in its capacity as a portfolio manager or restricted portfolio manager and not in its capacity as an exempt market dealer. For example, if a dually registered firm uses DEA to place trades through a participant dealer for its managed account clients, then it is using DEA in its capacity as a portfolio manager or restricted portfolio manager. Regulation 31-103 defines a managed account to mean an account of a client for which a person makes the investment decisions if that person has discretion to trade in securities for the account without requiring the client's express consent to a transaction. As a further example, if a firm uses DEA to place trades through a participant dealer for accounts of clients that are accredited investors (as defined in *Regulation 45-106 respecting Prospectus and Registration Exemptions*) but are not managed accounts, then it is using DEA in its capacity as an exempt market dealer, and therefore should not be using DEA for this trading activity.

Similarly, a foreign dealer that is also registered as an exempt market dealer is eligible for DEA if it only uses DEA when acting in its capacity as a foreign dealer and not in its capacity as an exempt market dealer.

(3) ***Order execution services***

The definition of DEA does not include order execution services provided pursuant to IIROC rules. The provision of order execution services is governed by the rules of IIROC.

It is our view that, in general, retail investors should not be using DEA and should be sending orders using order execution services. However, there are some circumstances in which individuals are sophisticated and have access to the necessary technology to use DEA (for example, former registered traders or floor brokers). In these circumstances, we expect that if a participant dealer chooses to offer DEA to an individual, the participant dealer will set standards high enough to ensure that the participant dealer is not exposed to undue risk. It may be appropriate for these standards to be higher than those set for institutional investors. All requirements relating to risk management and supervisory controls, policies and procedures would apply when providing DEA to an individual.

4.3. Standards for DEA clients

(1) ***Minimum standards***

A participant dealer's due diligence with respect to its clients is a key method of managing risks associated with providing DEA and necessitates a thorough vetting of potential DEA clients. As a result, section 4.3 requires the participant dealer to establish, maintain and apply reasonable standards for DEA and to assess and document whether each prospective DEA client meets these standards before providing DEA. A participant dealer's establishment, maintenance and application of reasonable standards for DEA would include evaluating its risks in providing DEA to a specific client. The participant dealer must establish, maintain and apply these standards with respect to all DEA clients. Subsection 4.3(2) sets out the minimum standards that the CSA consider necessary to ensure that a DEA client has sufficient financial resources to use direct electronic access and reasonable knowledge of both the order entry system and all applicable marketplace and regulatory requirements.

Each participant dealer has a different risk profile and as a result, we have provided flexibility to participant dealers in determining the specific levels of the minimum standards. We view these standards to be the minimum required for the participant dealer to properly manage its risks. The participant dealer should assess and determine what additional standards are reasonable given the particular circumstances of the participant dealer and each prospective DEA client. For example, a participant dealer might need to modify certain standards that it applies to an institutional client when determining whether an individual is suitable for receiving DEA.

Some additional factors a participant dealer could consider when setting such standards for prospective DEA clients include prior sanctions for improper trading activity, evidence of a proven track record of responsible trading, supervisory oversight, and the proposed trading strategy and associated volumes of trading.

(2) ***Monitoring the entry of orders***

The requirement in paragraph 4.3(2)(d) to monitor the entry of orders though DEA is expected to help ensure that orders comply with marketplace and regulatory requirements, meet minimum standards set for managing risk and do not interfere with fair and orderly markets.

(3) ***Annual confirmation***

Subsection 4.3(3) requires a participant dealer to confirm, at least annually, that each DEA client continues to meet the minimum standards established by the participant dealer. It is up to the participant dealer to choose the method of confirmation. Obtaining a written annual certification by the DEA client is one way to meet this requirement. If the participant dealer does not require a written annual certification, the participant dealer should record the steps it has taken to perform the annual confirmation in order to be able to demonstrate compliance with this requirement.

4.4. Written agreement

Section 4.4 sets out the provisions that must be included in a written agreement between a participant dealer and its DEA client. However, the participant dealer may include additional provisions in the agreement.

Paragraph 4.4(a)(iii) requires a DEA client to take all reasonable steps to prevent unauthorized access to the technology that facilitates direct electronic access and to not permit any person other than those authorized by the participant dealer, to use the direct electronic access provided by the participant dealer. The steps taken should be commensurate with the risks posed by the type of technology and systems that are being used.

Paragraph 4.4(a)(iv) specifies that when a participant dealer requests information from its DEA client in connection with an investigation or proceeding by any marketplace or regulation services provider with respect to trading conducted pursuant to the DEA provided, the information is required to only be provided to the marketplace or regulation services provider conducting the investigation or proceeding in order to protect the confidentiality of the information.

Paragraph 4.4(a)(vii) specifies that a DEA client will inform the participant dealer, in writing, of all individuals acting on the DEA client's behalf that it has authorized to use its DEA client identifier This requires a DEA client to formally authorize those individuals that will be using the DEA client identifier when trading for the DEA client.

4.5. Training of DEA clients

Pursuant to subsection 4.5(1), before providing DEA to a client, and as necessary after DEA is provided, a participant dealer must satisfy itself that the client has reasonable knowledge of applicable marketplace and regulatory requirements. What constitutes "reasonable knowledge" will depend on the particular client's trading activity and the associated risks presented by each specific client.

The participant dealer must assess the client's knowledge and determine what, if any, training is required in the particular circumstances. The training must, at a minimum, enable the DEA client to understand the applicable marketplace and regulatory requirements and how trading on the marketplace system occurs. For example, it may be appropriate for the participant dealer to require the client to have the same training required of an approved participant under UMIR.

After DEA has been provided, an assessment of the DEA client's knowledge of applicable marketplace and regulatory requirements would be considered necessary if significant changes to these requirements are made or if the participant dealer notices unusual trading activity by the DEA client. If the participant dealer finds the DEA client's knowledge to be deficient after such an assessment, the participant dealer should require additional training for the DEA client until the DEA client achieves the requisite level of knowledge or discontinue providing DEA to that DEA client.

4.6. DEA client identifier

(1) ***Assignment of DEA client identifier***

The purpose of requiring a unique identifier for each DEA client is to identify orders of clients entered onto a marketplace by way of DEA. Regulation 23-103 places the responsibility of assigning the DEA client identifier on the participant dealer. However, following current industry practice, the participant dealer will collaborate with the marketplace with respect to determining the necessary identifiers. We note that a DEA client may be assigned one or more DEA client identifiers.

(2) ***Information to marketplaces***

Subsection 4.6(2) requires a participant dealer to provide a DEA client identifier to each marketplace to which the DEA client has direct electronic access through that participant dealer. This provision is to ensure that marketplaces are aware of which trading channels contain DEA flow in order for marketplaces to properly manage their risks. The CSA does not expect that a DEA client's name will be disclosed to a marketplace. Instead, a participant dealer would need to provide only the DEA client identifier to a marketplace to enable the marketplace to more readily identify DEA flow.

4.7. Trading by DEA clients

Client orders passing through the systems of the DEA client

The CSA are of the view that DEA clients should not provide their DEA to their clients. Subsection 4.7(3) requires that if a DEA client is using DEA and trading for the account of a client, the client's orders must flow through the systems of the DEA client before being entered on a marketplace. This should be done regardless if the orders are sent directly or indirectly through a participant dealer.

This is meant to allow for those arrangements that the CSA are comfortable with, such as a DEA client acting as a "hub" and aggregating the orders of its affiliates before sending the orders to the participant dealer. Requiring orders to flow through the systems of the DEA client allows the DEA client to impose any controls it deems necessary or is required to impose under any requirements to manage its risks. Although the participant dealer is also required to have controls to manage its risks that arise from providing DEA to clients, including automatic pre-trade filters, it is the DEA client that has knowledge of the ultimate client. As a result, the DEA client is likely in a better position to determine the appropriate controls and parameters of those controls that are specific to each particular client. The participant dealer is responsible for ensuring that the DEA client has adequate controls in place to monitor the orders entering the DEA client's systems.

PART 3 REQUIREMENTS APPLICABLE TO THE USE OF AUTOMATED ORDER SYSTEMS

5. Use of automated order systems

Section 5 stipulates that a marketplace participant or any client must take all reasonable steps to ensure that its use of automated order systems does not interfere with fair and orderly markets. A marketplace participant must also take all reasonable steps to ensure that the use of an automated order system by a client does not interfere with fair and orderly markets. This includes both the fair and orderly trading on a marketplace or the market as a whole and the proper functioning of a marketplace. For example, the sending of a continuous stream of orders that negatively impacts the price of a security or that overloads the systems of a marketplace may be considered as interfering with fair and orderly markets.

Paragraph 5(3)(a) requires a marketplace participant to have a level of knowledge and understanding of any automated order systems used by either the marketplace

participant or the marketplace participant's clients that is sufficient to allow the marketplace participant to identify and manage the risks associated with the use of the automated order system. We understand that detailed information of automated order systems may be treated as proprietary information by some clients or third party service providers; however, the CSA expect that the marketplace participant will be able to obtain sufficient information in order to properly identify and manage its own risks.

Paragraph 5(3)(b) requires that each automated order system is tested in accordance with prudent business practices. A participating dealer does not necessarily have to conduct tests on each automated order system used by its clients but must satisfy itself that these automated order systems have been appropriately tested. Testing an automated order system in accordance with prudent business practices includes testing it before its initial use and at least annually thereafter. We would also expect that testing would also occur after any significant change to the automated order system is made.

PART 4 REQUIREMENTS APPLICABLE TO MARKETPLACES

6. Availability of order and trade information

(1) ***Reasonable access***

Subsection 6(1) is designed to ensure that a marketplace participant has immediate access to the marketplace participant's order and trade information when needed. Subsection 6(2) will help ensure that the marketplace does not have any rules, polices, procedures, fees or practices that would unreasonably create barriers to the marketplace participant in accessing this information.

This obligation is distinct from the requirement for marketplaces to disseminate order and trade information through an information processor under Parts 7 and 8 of Regulation 21-101. The information to be provided pursuant to section 6 would need to include the private information included on each order and trade in addition to the public information disseminated through an information processor.

(2) ***Immediate order and trade information***

For the purposes of providing access to order and trade information on an immediate basis, we consider a marketplace's provision of this information by a drop copy to be acceptable.

7. Marketplace controls relating to electronic trading

(1) ***Termination of marketplace access***

Subsection 7(1) requires a marketplace to have the ability and authority to terminate all or a portion of the access provided to a marketplace participant before providing access to that marketplace participant. This requirement also includes the authority of a marketplace to terminate access provided to a client that is using a participant dealer's marketplace participant identifier to access the marketplace. We expect a marketplace to act when it identifies trading behaviour that interferes with the fair and orderly functioning of its market.

(2) ***Assessments to be conducted***

Paragraph 7(2)(a) requires a marketplace to regularly assess and document whether the marketplace requires any risk management and supervisory controls, policies and procedures relating to electronic trading, in addition to the risk management and supervisory controls, policies and procedures that marketplace participants are required to have under subsection 3(1), and ensure that such controls, policies and procedures are implemented in a timely manner. As well, a marketplace must regularly assess and document the adequacy and effectiveness of any risk management and supervisory controls,

policies and procedures put in place under paragraph 7(2)(a). A marketplace is expected to document any conclusions reached as a result of its assessment and any deficiencies noted. It must also promptly remedy any identified deficiencies.

It is important that a marketplace take steps to ensure it does not engage in activity that interferes with fair and orderly markets. Part 12 of Regulation 21-101 requires marketplaces to establish systems-related risk management controls. It is therefore expected that a marketplace will be generally aware of the risk management and supervisory controls, policies and procedures of its marketplace participants and assess whether it needs to implement additional controls, policies and procedures to eliminate any risk management gaps and ensure the integrity of trading on its market.

(3) ***Timing of assessments***

A "regular" assessment would constitute, at a minimum, an assessment conducted annually and whenever a substantive change is made to a marketplace's operations, rules, controls, policies or procedures that relate to methods of electronic trading. A marketplace should determine whether more frequent assessments are required depending on the particular circumstances of the marketplace, for example when the number of orders or trades is increasing very rapidly or when new types of clients or trading activities are identified. A marketplace should document and preserve a copy of each such assessment as part of its books and records obligation in Regulation 21-101.

(4) ***Implementing controls, policies and procedures in a timely manner***

A "timely manner" will depend on the particular circumstances, including the degree of potential risk of financial harm to marketplace participants and their clients or harm to the integrity of the marketplace and to the market as a whole. The marketplace must ensure the timely implementation of any necessary risk management and supervisory controls, policies and procedures.

8. Marketplace thresholds

Section 8 requires that each marketplace must not permit the execution of orders of exchange-traded securities exceeding price and volume thresholds set by its regulation services provider, or by the marketplace if it is a recognized exchange or recognized quotation and trade reporting system that directly monitors the conduct of its members or users and enforces certain requirements set under Regulation 23-101.

These price and volume thresholds are expected to reduce erroneous orders and price volatility by preventing the execution of orders that could interfere with a fair and orderly market.

There are a variety of methods that may be used to prevent the execution of these orders. However, the setting of the price threshold is to be coordinated among all regulation services providers, recognized exchanges and recognized quotation and trade reporting systems that set the threshold under subsection 8(1).

The coordination requirement also applies when setting a price threshold for securities that have underlying interests in an exchange-traded security. We note that there may be differences in the actual price thresholds set for an exchange-traded security and a security that has underlying interests in that exchange-traded security.

9. Clearly erroneous trades

(1) ***Application of section 9***

Section 9 provides that a marketplace cannot provide access to a marketplace participant unless it has the ability to cancel, vary or correct a trade executed by that marketplace participant. This requirement would apply in the instance where the marketplace decides to cancel, vary or correct a trade or is instructed to do so by a regulation services provider.

Before cancelling, varying or correcting a trade, paragraph 9 (2)(a) requires that a marketplace receive instructions from its regulation services provider, if it has retained one. We note that this would not apply in the case of a recognized exchange or recognized quotation and trade reporting system that directly monitors the conduct of its members or users and enforces requirements set pursuant to subsection 7.1(1) or 7.3(1) respectively of Regulation 23-101.

(2) ***Cancellation, variation or correction where necessary to correct a system or technological malfunction or error made by the marketplace systems or equipment***

Under paragraph 9(2)(c) a marketplace may cancel, vary or correct a trade where necessary to correct an error caused by a system or technological malfunction of the marketplace's systems or equipment or an individual acting on behalf of the marketplace. If a marketplace has retained a regulation services provider, it must not cancel, vary or correct a trade unless it has obtained permission from its regulation services provider to do so.

Examples of errors caused by a system or technological malfunction include where the system executes a trade on terms that are inconsistent with the explicit conditions placed on the order by the marketplace participant, or allocates fills for orders at the same price level in a manner or sequence that is inconsistent with the stated manner or sequence in which such fills are to occur on the marketplace. Another example includes where the trade price was calculated by a marketplace's systems or equipment based on some stated reference price, but it was calculated incorrectly.

(3) ***Policies and procedures***

For policies and procedures established by the marketplace in accordance with the requirements of subsection 9(3) to be "reasonable", they should be clear and understandable to all marketplace participants.

The policies and procedures should also provide for consistent application. For example, if a marketplace decides that it will consider requests for cancellation, variation or correction of trades in accordance with paragraph 9(2)(b), it should consider all requests received regardless of the identity of the counterparty. If a marketplace chooses to establish parameters only within which it might be willing to consider such requests, it should apply these parameters consistently to each request, and should not exercise its discretion to refuse a cancellation or amendment when the request falls within the stated parameters and the consent of the affected parties has been provided.

When establishing any policies and procedures in accordance with subsection 9(3), a marketplace should also consider what additional policies and procedures might be appropriate to address any conflicts of interest that might arise.

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Split/Merged cell	
Padding cell	

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REGULATION TO AMEND REGULATION 11-102 RESPECTING PASSEPORT SYSTEM

Securities Act
(R.S.Q., c. V-1.1, s. 331.1, par. (11), (32) and (33.8))

1. Appendix D of Regulation 11-102 respecting Passport System is amended by replacing the row that refers to Regulation 23-103 with the following:

“

Electronic trading and direct electronic access to marketplaces	Regulation 23-103 (only sections 3(1), 3(2), 3(3)(a) to 3(3)(d), 3(4) to 3(7), 4, 4.2, 4.3, 4.4(a)(ii), 4.4(a)(iii), 4.4(a)(v) to 4.4(a)(vii), 4.4(b), 4.5, 4.7 and 5(3))

”.

2. Appendix E of the Regulation is amended by replacing « - Regulation 23-103 respecting Electronic Trading (c. V-1.1, r. X) », with the following row:

“- Regulation 23-103 respecting Electronic Trading and Direct Electronic Access to Marketplaces (c. V-1.1, r. X)”.

3. This Regulation comes into force on (*insert the date of coming into force of this Regulation*).