



**"Marketplace Regulation: Today's Focus and Tomorrow's Challenges"**

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Good morning. I want to thank the Canadian Security Traders Association (CSTA) for inviting the OSC to speak at your annual conference here in the beautiful Laurentians.

The trader community is near and dear to me and I welcome this opportunity to engage with you on some of the work we're doing in market regulation, as well as certain developments in the marketplace. I'm happy to take your questions after my remarks.

I'm glad to see many in the audience who attended the OSC-IIROC market structure conference in June. The OSC, like the CSTA, thinks that it is very important to gather market participants together to discuss issues that are top of mind for all of us. The OSC- IIROC conference was an excellent forum to exchange ideas with stakeholders. The discussions were lively and, at times, provocative – as they are here!

One week after our conference the Commission published final recognition orders and terms and conditions for the Maple transaction. A few weeks later, as you know, TMX shareholders accepted the takeover offer. So a lot has changed in the structure of Canada's equity market this summer, though the principles of regulation remain the same – the protection of investors, fostering fair and efficient capital markets and fostering confidence in those markets.

In my remarks today, I'm going to keep it simple. I'll provide you with an update on some of the OSC's market regulation priorities and then discuss a few developments that we're following for possible future action.

## **Areas of OSC Focus**

As capital markets become more complex and interconnected, and as many of the regulatory concerns are increasingly linked together, it's often difficult to identify the cause and effect of different phenomena in the marketplace. As regulators, we examine the important issues, analyze them and try to look for creative solutions. We look at the issues holistically and consider the impact on both the market and participants.

The OSC has already tackled some of the major issues facing our equity market in recent years, including complexity, liquidity and access. Working with our regulatory partners, we have:

- Introduced the order protection rule;
- Developed a new regulatory framework for dark pools;
- Revised amendments to National Instruments 21-101 and 23 -101 – the marketplace rules – to address differences in regulation between ATSS and exchanges, where appropriate; and
- Finalized requirements for dealers to have pre-trade controls in the Electronic Trading Rules.

But since the equity market doesn't ever stand still, neither can the regulators. So we have a number of initiatives underway, three of which I want to highlight here.

First, trading fees, including the maker-taker model.

It has been argued by some that the maker-taker fee model is distorting market behaviour and causing inefficiencies and unfairness in the markets. Some observers say the model negatively impacts transparency and liquidity by creating incentives for certain types of trading behaviour. Others say it's part of the natural evolution of the marketplace.

The OSC is examining the maker-taker model. Along with our colleagues at the International Organization of Securities Commissions (IOSCO), we're looking at the impact of the maker-taker structure on many markets and other considerations. It's early days still but, at the appropriate time, we will reach out to the industry for your knowledge, views and data on trading fees to ensure the decisions we make will be well informed and right for our market.

Next, market data fees.

Analyzing market data fees is incredibly complex, as you know, and it's important that we compare apples to apples as we study the issue. Right now, we're drafting a consultation paper that will present our analysis of market data fees and possible options to address the concerns raised. These options include:

- Regulating fees charged for consolidated data or core data;
- Imposing caps on fees; and
- Not allowing marketplaces to charge data fees until they reach a certain threshold of market share.

We will not be making specific recommendations in the consultation paper as we want to get as much input as possible on the options first. So when the consultation paper is published for comment in the fall, I encourage your comments and I definitely know this group of professionals won't be shy.

The third key initiative I want to mention is best execution reporting. We first proposed best execution reporting requirements in 2007 and again in 2008. Those proposals would have required marketplaces to publish monthly statistics and metrics on marketplace quality factors such as liquidity, speed and certainty of execution. These were intended to assist dealers and advisers in assessing best execution. Dealers would have also been required to publish quarterly reports on their routing activities when acting as an agent, along with disclosure of any material arrangements between a dealer and marketplace.

As you know, we did not proceed with the implementation of those proposals. The comments on them were mixed and the extent to which the multiple marketplace environment had evolved caused us to consider whether the proposed obligations should be further refined. Since then, we have continued to monitor developments in other jurisdictions regarding best execution reporting requirements, including the questions raised by the Securities and Exchange Commission in its 2010 Concept Release on Equity Market Structure.

We think that it's now an appropriate time to look at best execution reporting again. But we're starting at first principles because the trading environment has changed significantly since 2008. Information is more accessible, and dealers and advisers are leveraging technology more to assess best execution and for carrying out their best execution policies. We're in the early stages of our analysis and will be reaching out to you to talk about the extent to which information necessary for assessing best execution is lacking and whether regulations might be necessary to ensure access to that information.

### **Looking forward**

Regulating the securities markets always requires a balance between acting on specific initiatives, such as the ones I've just mentioned, but also reading the horizon for emerging developments. To better understand how the markets are changing, OSC Market Regulation staff continually examine structures, conduct, technology, and trading behaviour. We talk to stakeholders and investors about their concerns. And we're using more research and data analysis to support policy initiatives with evidence-based decisions.

Trades move at speeds measured in milliseconds and even microseconds thanks to the proliferation of complex strategies and algorithms. Recent U.S. market events demonstrate that the speed and complexity of trading requires a greater focus on the tools and controls designed to mitigate the risks associated with electronic trading.

As you know, we have a new rule that sets a framework for electronic trading, including the requirement for pre-trade filters. But as technology evolves, so must our regulatory framework. We'll continue to assess the impact of technology on the markets to identify possible risks to determine if we have the appropriate framework in place and whether other risk controls are necessary. But we should only intervene when a regulatory response is required.

We are also examining marketplace operations and filings with a view to the new provisions in National Instrument 21-101 *Marketplace Operation*, which came into force on July 1, 2012. The provisions require that marketplaces focus on fair and orderly markets and fair access, and that there is a greater emphasis on transparency of marketplace operations to the public. It is with this in mind that we examine the products and services that are offered by marketplaces.

We are also working to ensure that, as the market changes, we have the information at hand to effectively monitor compliance with our rules.

The SEC just introduced its Consolidated Audit Trail (CAT) plan to monitor and analyze equity trading in the U.S. We're watching the development of the CAT with great interest because we know from experience the value of audit trail data to regulators. Many of you will know that IIROC's STEP system provides us with audit trail information from all of the marketplaces. We receive data right from the time the order hits the marketplace. In addition, the existing dealer audit trail requirements are contained in National Instrument

23-101 *Trading Rules* which mandates the maintenance of audit trail information within the dealer.

However, there *is* a piece missing: we don't have the two trails linked together electronically. The CAT system in the U.S. seems to make that link. Arguably, we *don't* need a single system like CAT here in Canada. But what we are missing is the inclusion of a client ID in the data which follows the order into the marketplace. This was the big obstacle and the major cost for an earlier look at audit trails that many of you will recall as TREATS. However, as trading becomes faster and more complex, the importance of having client IDs in the data trail grows. This is something that we will examine further to ensure that we have the appropriate tools for market surveillance.

We are also participating in international discussions about the development of a global Legal Entity Identifier (LEI) system that would identify unique counterparties to financial transactions. The proposed LEI system is part of the G20's commitment to strengthen the regulation of OTC derivatives markets. The OSC represents IOSCO on the FSB LEI Implementation Group, which is examining issues related to developing and implementing the Global LEI System. The FSB wants to have a functioning governance structure and an operational framework for a global LEI system by March 2013. Eventually, the LEI framework could be extended to other financial transactions, including those in the equity market.



You'll note that many of the regulatory issues I've talked about today have international implications. The link between global regulatory priorities and domestic concerns underscores how regulators around the world are looking at the same issues, be it OTC derivatives regulation or high frequency trading, to cite just two examples. International regulatory co-operation is a longstanding priority for the OSC and we continue to make significant contributions to the global reform agenda. We work closely with IOSCO on areas of mutual interest which, in turn, is helping the development of policy in Canada which is aligned with international standards. We're a representative of Canada at the IOSCO table, addressing important market regulation issues that affect both Canadian and global markets. We understand that enhanced co-operation between the OSC and our international counterparts is vital in delivering on the OSC's commitments to protect investors, mitigate systemic risk and foster confidence in Canada's capital markets.

## **Conclusion**

The OSC's public interest mandate guides us to maintain a regulatory framework that fosters markets characterized by integrity, transparency, liquidity, immediacy and competitiveness, which are the attributes of a fair and efficient market.

Fairness for both investors and market participants is paramount. Investors, issuers and the wider economy depend on the integrity and stability of our capital markets, whose competitiveness and vitality generate opportunities to create wealth and economic growth. So securities regulators and the securities industry have a mutual interest in sustaining a fair, robust and efficient equity market.

As a regulator, we need to understand the concerns of dealers, buy-side participants, marketplaces and other market participants, just as we need to understand the concerns of retail and institutional investors. We also understand that, at times, you want regulators to move faster and to coordinate our actions more efficiently. Indeed, we're always trying to improve efficiencies, but you must understand that the OSC can't regulate in isolation. We have to work within the CSA, with IOSCO and consult, when appropriate, with the provincial government, to whom we are accountable.

Which brings me back to my message about consultations with stakeholders. I want to stress the value of your feedback, your comments, and, yes, even your criticism. All of this input assists us in our work. Your views enable us to see the bigger picture. And, in the end, engaged stakeholders like the CSTA and its members help the OSC to achieve its goal to make effective and relevant policy that achieves our mandate to provide protection to investors and foster fair and efficient capital markets and confidence in markets.

Thank you. I hope you enjoy the rest of the conference.