

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 IIROC Rules Notice – Request for Comment – Dealer Member Rules

**RULES NOTICE
REQUEST FOR COMMENT
DEALER MEMBER RULES**

**10-0097
April 9, 2010**

Trade Confirmation and Matching Requirements

Summary of nature and purpose of Proposed Amendments

On March 24, 2010, the Board of Directors (“Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved the publication for comment of proposed amendments (“Proposed Amendments”) to the Dealer Member Rules 800.49 and 200.1(h) (“Rule 800.49 and Rule 200.1(h)”). The primary objectives of the Proposed Amendments are to promote compliant trade matching practices, as well as to eliminate the sending of duplicative trade related correspondence to clients. More specifically, the Proposed Amendments to Rule 800.49 seek to provide Dealer Members with greater clarity with respect to their broker-to-broker trade reporting and matching requirements while the Proposed Amendments to Rule 200.1(h) provide Dealer Members with an exemption from the trade confirmation requirements in Rule 200.1(h), provided that certain conditions are met.

Issues and specific Proposed Amendments

Relevant History

Rule 800.49 – Broker-to-broker trade matching

Mitigating non-exchange trade settlement risk and promoting settlement efficiency among Dealer Members are priorities for IIROC. It is desirable to amend Rule 800.49 to provide Dealer Members with greater clarity regarding their broker-to-broker trade matching and reporting requirements.

Rule 200.1(h) – Trade confirmation requirements

Given that trade data elements have already been agreed to through the trade matching process described in Rule 800.49 and National Instrument 24-101- Institutional Trade Matching and Settlement (“NI 24-101”), Dealer Members and clients have expressed the desire to eliminate trade confirmation requirements contained in Rule 200.1(h). In light of these requests and the existing extensive legislative and regulatory requirements that ensure trade data elements have been reported and affirmed by the client, it is appropriate to amend the existing Rule 200.1(h) to provide Dealer Members with exemptive relief from their trade confirmation requirements, provided that certain conditions are met.

Updates to those rules dealing with a trade confirmation’s required marketplace disclosure are also being made in order to require the disclosure of:

- all marketplaces, not only exchanges; and
- the circumstances in which a trade is executed on more than one marketplace.

Current Rules

Rule 800.49 – Broker-to-broker trade matching

Currently, Rule 800.49 requires that for each non-exchange trade, involving CDS eligible securities, executed by a Dealer Member with another Dealer Member, each Dealer Member must:

- enter the trade into an Acceptable Trade Matching Utility; or
- accept or reject any trade entered by another Dealer Member within one hour of trade execution.

Rule 800.49 is designed to mitigate non-exchange trade settlement risk and promote settlement efficiency by ensuring more timely agreement of trade details.

Rule 200.1(h) – Trade Confirmation Requirements

Rule 200.1(h) requires that every Dealer Member who acts as principal or agent in connection with any trade in a security must send a prompt confirmation of the transaction to the customer of the account on a trade by trade basis. Pursuant to Rule 200.1(h), the confirmation must include, among other things, the following information:

1. The date and the stock exchange or commodity futures exchange upon which a trade took place;
2. The commission, if any, charged in respect of a trade;
3. The fee or other charge, if any, levied by any securities regulatory authority in connection with a trade;
4. The name of the salesperson, if any, in a transaction; and
5. The name of the dealer, if any, used by the Dealer Member as its agent to effect a trade.
6. Furthermore, trade confirmations currently require Dealer Members to disclose “the stock exchange or commodity futures exchange” upon which a trade took place.

Proposed Rules

Rule 800.49 – Broker-to-broker trade matching

The Proposed Amendments to Rule 800.49 provide greater clarity to Dealer Members with respect to their trade reporting and matching requirements. Additionally, the Proposed Amendments are consistent with the recently proposed amendments to the institutional trade requirements set out in NI 24-101. The Proposed Amendments to Rule 800.49 will:

1. extend trade reporting requirement from the current “within one hour of trade execution” standard to “at or before 6:00 p.m. on the day of the trade”;
2. define a “non-exchange trade”;
3. provide guidance that will allow Dealer Members to easily classify trades as being either compliant or non-compliant with the reporting requirements; and
4. establish an acceptable monthly compliant trade percentage threshold.

With respect to the proposed revision to the timing of trade reporting, IIROC staff has analysed the Dealer Members’ existing rule compliance percentages and has determined that in any given month between 30% and 40% of all non-exchange, broker-to-broker trades are not reported for trade matching within the hour, as required by the current rule. The reason for this is largely system-related, in that many Dealer Members do not have automated intra-day trade reporting functionality and instead report trades on an “end of day” batch basis. Given that operational reality, as well as the fact that moving to T+1 trade settlement is no longer a regulatory priority in Canada or abroad, continuing to require non-exchange broker-to-broker trades to be reported within the hour for trade matching is unnecessary. The proposed rule amendment would, therefore allow Dealer Members to report trades on an “end of day” (i.e. 6:00 p.m.) basis, via batch reporting systems. Allowing for this flexibility will address the current systems-related issues without introducing material delays in the matching of trades. IIROC believes that this will result in a significantly higher rate of compliance with the trade reporting requirements which will, in turn, allow Dealer Members and IIROC to focus on the residual, non-complaint trades (i.e. trades in which terms have not been agreed to and/or where there are recurring trade reporting errors) that represent the greatest settlement risk.

With respect to the proposed introduction of a definition for the term “non-exchange trade”, IIROC staff has determined that there is confusion over which trades must be reported under the current trading matching rule, therefore a specific definition of trades to which the rule applies is necessary. The proposed definition codifies previously issued guidance on this issue.

With respect to the proposed revision relating to the classification of trades, IIROC staff has included tables within the rule that identify each possible trade reporting scenario and define each scenario as either:

- i. a compliant trade;
- ii. a non-compliant trade; or
- iii. a don't know (DK) trade.

These classifications will be used by CDS and other matching service providers to calculate rule compliance percentages.

The proposal to introduce a monthly "compliant trade percentage" threshold and non-compliance reporting requirements is similar to the requirements found in NI 24-101. Dealer Members who fail to meet the monthly compliant trade percentage threshold will be required to promptly report their:

- compliant trade percentage; and
- action plan to increase their compliant trade percentage to the minimum acceptable level

in writing to IIROC.

The proposed percentage thresholds are consistent with the proposed compliant trade percentage thresholds contained in revised NI 24-101, namely:

- 85% or more for months ending prior to or on June 30, 2012; and
- 90% or more for months beginning on or after July 1, 2012.

Failure to meet the minimum compliant trade percentage standard will be grounds for disciplinary action. Furthermore non-compliant Dealer Members will not be eligible for exemptive relief, relating to trade confirmations, included in the Proposed Amendments to Rule 200.1(h). A copy of the Proposed Amendments to Rule 800.49 is set out in Attachment A.

Dealer Member Rule 200.1(h) – Trade Confirmation Requirements

The trade confirmation requirement theme is also included in the trade matching and reporting requirements set out in Rule 800.49 and NI 24-101. Specifically,

1. *For trades involving other Dealer Members:* Dealer Members must enter or accept or reject the trade details for non-exchange traded securities through an Acceptable Trade Matching Utility, as defined in Rule 800.49, in accordance with the requirements of Rule 800.49; and
2. *For trades involving delivery against payment (DAP) and receipt against payment (RAP) account customers other than Dealer Members:* trade details must be matched with the customer or the customer's custodian in accordance with the requirements of NI 24-101.

Rule 800.49 and NI 24-101 require Dealer Members to establish processes and procedures that promote trade matching within prescribed limits and ensure compliance with performance standards. For example, as part of the trade matching process the following trade data elements are transmitted, compared and agreed upon through an Acceptable Trade Matching Utility:

- Security identification: standard numeric identifier, currency, issuer, type/class/series, market type; and
- Order and trade information: dealer ID, account ID, account type, buy/sell indicator, order status, order type, unit price/face amount, number of securities/quantity, message date/time, trade transaction type, commission, accrued interest (fixed income), broker settlement location, block reference, net amount, settlement type, allocation sender reference, custodian, payment indicator, IM portfolio/account ID, quantity allocated, and settlement conditions.

In addition to the trade matching requirements contained in Rules 200.1(h), 800.49 and NI 24-101, the legislative and regulatory audit trail and statement requirements as well as the industry's existing best practices and standards, should ensure that trade data elements have been reported and affirmed by the client. For example:

1. *Audit Trail Requirements - Part 11 of National Instrument 23-101 – Trading Rules ("NI 23-101")* requires that Dealer Members construct an electronic audit trail of order, quotation and transaction data. Specifically, Dealer Members are required to maintain, and provide to clients upon request, detailed records respecting: (a) receipt or origination of an order, (b) transmission of an order, (c) variation or correction or cancellation of an order, and (d) execution of an order. Furthermore, there are additional particulars set out in Part 11 of NI

23-101 that are not expressly set out in Rule 200.1(h), such as the order and dealer identifiers, and whether an order was varied/corrected/cancelled on instructions of the client or the dealer.

2. *Statements* - Dealer Members are required to provide each client with a statement in accordance with section 14.14 of NI 31-103 – Registration Requirements and Exemptions and Dealer Member Rule 200.1(c).
3. *Industry Best Practices and Standards* - Dealer Members must ensure compliance with industry best practices and standards with respect to minimum trade elements for the purposes of trade matching, reporting/affirmation, clearing and settlement. Dealer Members must be equipped with electronic tools that permit customers to have real-time access to trade details through the Dealer Members' proprietary execution management systems.

The requirements listed under Rule 800.49 and NI 24-101, coupled with Dealer Members' obligations to retain sufficient records for audit and review purposes, provide monthly statements and promote industry best practices and standards creates an extensive legislative and regulatory framework that ensures trade data elements have been reported and affirmed by the client. In light of these requirements, the Proposed Amendments to Rule 200.1(h) provide exemptive relief to Dealer Members who meet their trade matching and reporting requirements pursuant to Rule 800.49 or NI 24-101, satisfy the compliant trade matching percentage, obtain prior written consent by the client to waive receipt of trade confirmations, match trades through an electronic means and maintain an electronic audit trail of the matched trade pursuant to NI 23-101.

The application of Rule 200.1(h) to Dealer Members who are also subject to Rule 800.49 or NI 24-101 is therefore, redundant and creates needless correspondence to the client since each of the trade data elements have already been reported/affirmed by the client or the client's custodian and the trade has been allocated with instructions for delivery.

As part of the amendments being made to Rule 200.1(h), updates to the marketplace disclosure requirement are also being made. Currently, written trade confirmations must disclose "the stock exchange or commodity futures exchange" upon which a trade took place. This requirement does not capture trades executed outside of recognized exchange facilities, such as quotation and trade reporting systems and alternative trading systems, as well as circumstances in which trades are executed on more than one marketplace. The Proposed Amendment would account for all marketplaces and for trades that are executed on more than one of these marketplaces. In addition to the Proposed Amendments to the marketplace disclosure requirements, the Market Regulation Policy Department will issue guidance on marketplace disclosure language acceptable to IIROC. A copy of the Proposed Amendments to Rule 200.1(h) is attached as Attachment B.

Issues and alternatives considered

In developing the amendments to Rule 800.49, a two to three hour extension from the current one hour reporting requirement was also considered but, it was decided that this would have proven to be more difficult to comply with and enforce in comparison to the 6 p.m. deadline for all trades.

The possibility of leaving Rule 200.1(h) unchanged was also considered but this alternative was dismissed given the growing insistence of DAP and RAP account clients to eliminate the trade confirmation requirement for matched trades.

Proposed Amendments Classification

Statements have been made elsewhere as to the nature and effects of the Proposed Amendments, as well as analysis. The purposes of the Proposed Amendments are to:

- Establish and maintain rules that are necessary or appropriate to govern and regulate all aspects of IIROC's functions and responsibilities as a self-regulatory entity;
- Ensure compliance with securities laws;
- Promote just and equitable principles of trade and the duty to act fairly, honestly and in good faith; and
- Foster cooperation and coordination with entities engaged in regulating, clearing, settling, processing information with respect to, and facilitating, securities.

The Board therefore has determined that the Proposed Amendments are not contrary to public interest.

Due to the extent and substantive nature of the Proposed Amendments, they have been classified as Public Comment Rule proposals.

Effects of the Proposed Amendments on market structure, Dealer Members, non-Dealer Members, competition and costs of compliance

The Proposed Amendments will not have any significant effects on Dealer Members or non-Dealer Members, market structure or competition. Furthermore, it is not expected that there will be any significant increased costs of compliance as a result of the Proposed Amendments.

The Proposed Amendments do not impose any burden or constraint on competition or innovation that is not necessary or appropriate in furtherance of IIROC's regulatory objectives. They do not impose costs or restrictions on the activities of market participants (including Dealer Members and non-Dealer Members) that are disproportionate to the goals of the regulatory objectives sought to be realized.

Technological implications and implementation plan

The Proposed Amendments will have no impact on Dealer Members' systems. As such, it is intended that the Proposed Amendments will be implemented shortly after approval is received from IIROC's recognizing regulators.

Request for public comment

Comments are sought on the Proposed Amendments. Comments should be made in writing. Two copies of each comment letter should be delivered by June 8, 2010 (60 days from the publication date of this notice). One copy should be addressed to the attention of:

Angie F. Foggia
Policy Counsel, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 1600, 121 King Street West
Toronto, Ontario, M5H 3T9

The second copy should be addressed to the attention of:

Manager of Market Regulations
Ontario Securities Commission
19th Floor, Box 55
20 Queen Street West
Toronto, Ontario, M5H 3T9
marketregulation@osc.gov.on.ca

Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca) under the heading "IIROC Rulebook – Dealer Member Rules – Policy Proposals and Comment Letters Received".

Questions may be referred to:

Angie F. Foggia
Policy Counsel, Member Regulation Policy
Investment Industry Regulatory Organization of Canada
416.646.7203
afoggia@iiroc.ca

Attachments

- Attachment A – Proposed Amendments to Rule 800.49 – Broker-to-broker non-exchange trade matching
- Attachment B – Proposed Amendments to Rule 200.1(h) – Trade confirmation requirements

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

RULE 800.49 – BROKER-TO-BROKER NON-EXCHANGE TRADE MATCHING PROPOSED AMENDMENTS

1. Rule 800.49 is amended by deleting it in its entirety and replacing it with the following:

“800.49. Broker-to-broker non-exchange trade matching

(1) Trade matching requirement

For each non-exchange trade, involving a *CDS eligible security* that is executed by a *Dealer Member* with another *Dealer Member*, each *Dealer Member* must:

- (i) Enter the trade into an *acceptable trade matching utility* or
- (ii) Accept or reject any trade entered into an *acceptable trade matching utility* by another *Dealer Member*.

at or before 6 p.m. (Toronto time) on the day the trade was executed.

(2) Definition of non-exchange trade

For the purposes of this Rule a non-exchange trade is defined as any trade in a *CDS eligible security* (excluding new issue trades and repurchase and reverse repurchase transactions) between two *Dealer Members*, which has not been submitted to the CDS continuous net settlement service, CDSX, by a recognized exchange. The dealer to dealer portion of a jitney trade that is executed between two *Dealer Members* that is not reported by a recognized exchange is a non-exchange trade.

(3) List of acceptable trade matching utilities

The Corporation maintains a list of *acceptable trade matching utilities* that is published from time to time

(4) Trade classification where a Dealer Member enters a trade into the matching utility

If a *Dealer Member* enters a trade into an *acceptable trade matching utility* under clause 800.49(1)(i), the trade is considered for each dealer trade counterparty to be a *compliant trade*, a *don't know trade* or a *non-compliant trade* according to the following table:

		Action of other Dealer Member					
		Enter trade at or before 6 p.m.	Accept trade at or before 6 p.m.	Enter or accept trade after 6 p.m.	Reject trade at or before 6 p.m.	Reject trade after 6 p.m.	No action
Action of Dealer Member	Enter trade at or before 6 p.m.	- Dealer Member compliant trade	- Dealer Member compliant trade	- Dealer Member compliant trade	- Dealer Member don't know or DK trade	- Dealer Member don't know or DK trade	- Dealer Member compliant trade
		- Other Dealer Member compliant trade	- Other Dealer Member compliant trade	- Other Dealer Member non-compliant trade	- Other Dealer Member don't know or DK trade	- Other Dealer Member non-compliant trade	- Other Dealer Member non-compliant trade
	Enter trade after 6 p.m.	- Dealer Member non-compliant trade		- Dealer Member non-compliant trade		- Dealer Member non-compliant trade	- Dealer Member non-compliant trade
		- Other Dealer Member compliant trade		- Other Dealer Member non-compliant trade		- Other Dealer Member don't know or DK trade	- Other Dealer Member non-compliant trade

(5) Trade classification where a Dealer Member does not enter a trade into the matching utility

If a Dealer Member accepts or rejects a trade entered into an acceptable trade matching utility by another Dealer Member under clause 800.49(1)(ii) or takes no action on a trade entered into an acceptable trade matching utility by another Dealer Member, the trade is considered for each dealer trade counterparty to be a compliant trade, a don't know trade or a non-compliant trade according to the following table:

		Action of other Dealer Member	
		Enter trade at or before 6 p.m.	Enter trade after 6 p.m.
Action of Dealer Member	Accept at or before 6 p.m.	<ul style="list-style-type: none"> - Dealer Member compliant trade - Other Dealer Member compliant trade 	
	Accept after 6 p.m.	<ul style="list-style-type: none"> - Dealer Member non-compliant trade - Other Dealer Member compliant trade 	<ul style="list-style-type: none"> - Dealer Member non-compliant trade - Other Dealer Member non-compliant trade
	Reject at or before 6 p.m.	<ul style="list-style-type: none"> - Dealer Member don't know or DK trade - Other Dealer Member don't know or DK trade 	
	Reject after 6 p.m.	<ul style="list-style-type: none"> - Dealer Member non-compliant trade - Other Dealer Member don't know or DK trade 	<ul style="list-style-type: none"> - Dealer Member don't know or DK trade - Other Dealer Member non-compliant trade
	No action	<ul style="list-style-type: none"> - Dealer Member non-compliant trade - Other Dealer Member compliant trade 	<ul style="list-style-type: none"> - Dealer Member non-compliant trade - Other Dealer Member non-compliant trade

(6) **Determination of monthly compliant trade percentage**

The monthly compliant trade percentage for a Dealer Member is determined by dividing the sum of month's compliant trades (which does not include don't know trades) by the total number of non-exchange trades that are executed during the month by the Dealer Member with other Dealer Members.

For months ending prior to or on June 30, 2012, a Dealer Member must promptly report to the Corporation when this monthly compliant trade percentage is less than 85% in any month and must include in this report its action plan to improve its percentage. Failure to increase the compliant trade percentage to 85% or more within 3 months of the first sub-standard report will be grounds for the Corporation to pursue disciplinary action.

Beginning on or after July 1, 2012, a Dealer Member must promptly report to the Corporation when their monthly compliant trade percentage is less than 90% in any month and must include in this report its action plan to improve its percentage. Failure to increase the compliant trade percentage to 90% or more within 3 months of the first substandard report will be grounds for the Corporation to pursue disciplinary action."

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA
DEALER MEMBER RULE 200.1(h) – TRADE CONFIRMATION REQUIREMENTS
PROPOSED AMENDMENTS

Dealer Member Rule 200.1(h) is amended by:

1. Replacing “the stock exchange or commodity futures exchange upon which the trade took place” in the second sentence and replacing it with “the marketplace or marketplaces upon which the trade took place, or marketplace disclosure language acceptable to the *Corporation*”; and
2. Adding the following language directly at the end of 200.1(h):

“Exemption:

For delivery against payment (DAP) and receipt against payment (RAP) trade accounts, a *Dealer Member* is not required to send a trade confirmation if:

- (i) the trade is either subject to or matched in accordance with broker-to-broker or institutional trade matching requirements under *the Corporation’s* Rules or securities legislation;
- (ii) the *Dealer Member* maintains an electronic audit trail of the trade under *the Corporation’s* Rules or securities legislation;
- (iii) prior to the trade, the client has agreed in writing to waive receipt of trade confirmations from the *Dealer Member*;
- (iv) the client is either:
 - (a) another *Dealer Member* who is reporting or affirming trade details through an *acceptable trade matching utility* in accordance with Rule 800.49; or
 - (b) a DAP/RAP account customer other than a *Dealer Member* who is matching trades (either directly or through a custodian) in accordance with National Instrument 24-101- Institutional Trade Matching and Settlement;
- (v) the *Dealer Member* has real-time access to, and can download into their own system from the *acceptable trade matching utility’s* or the matching service utility’s system, trade details that are similar to the prescribed information under Rule 200.1(h); and
- (vi) the *Dealer Member* is in compliance with the trade matching requirements under *the Corporation’s* Rules or securities legislation relevant to the trade.

A client may terminate their trade confirmation waiver, referred to in Rule 200.1(h)(2)(iii), by providing a written notice confirming this fact to the Dealer Member. The termination notice takes effect upon the Dealer Member’s receipt of the notice.”