

IIROC NOTICE

Rules Notice Request for Comments

UMIR

Comments Due By: August 8, 2016

Please distribute internally to:

Institutional
Legal and Compliance
Senior Management
Trading Desk
Retail

Contact:

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**16 - 0123
June 9, 2016**

Proposed Provisions Respecting Designations and Identifiers

Executive Summary

IIROC is proposing amendments to the Universal Market Integrity Rules (“UMIR”) that would:

- introduce a new order designation to identify orders that bundle together client, non-client and/or principal orders. This “bundled order” designation would, in many cases, eliminate the requirement to unbundle trades at the end of the day by filing a Corrections Report to the Regulatory Marker Correction System
- introduce a new designation to identify derivative-related crosses that involve little or no economic transfer of risk. This cross designation would be publicly disseminated in the same manner as an intentional or internal cross and provide added transparency to our markets
- modify the existing bypass order marker from a public to a non-public marker for bypass orders that are not part of a designated trade. This change would help to prevent potential information leakage of future orders.

If the Proposed Amendments are approved, Dealer Members, marketplaces and other stakeholders would need to make any necessary technology changes to accommodate the new designations and the change to the bypass order marker.



If approved, we expect that the Proposed Amendments would become effective 90 days after the Notice of Approval is published.

How to Submit Comments

We request comments on all aspects of the Proposed Amendments, including any matter which they do not specifically address. Please send your comments on the Proposed Amendments in writing by **August 8, 2016** to:

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Investment Industry Regulatory Organization of Canada
Suite 2000
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Toronto, Ontario M5H 3T9
email: tlam@iroc.ca

Please also forward a copy of your comments to the Recognizing Regulators to:

Market Regulation
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, Ontario M5H 3S8
Fax: (416) 595-8940
email: marketregulation@osc.gov.on.ca

Please note that a copy of your comment letter will be posted and publicly available on the IIROC website at www.iroc.ca.



Rules Notice - Table of Contents

1.	Discussion of Proposed Amendments.....	4
1.1	<i>Bundled Order Designation</i>	4
1.2	<i>Derivative-Related Cross Designation</i>	5
1.3	<i>Bypass Marker Transparency</i>	5
2.	Analysis	6
2.1	<i>Bundled Order Designation</i>	6
2.1.1	<i>Client Priority</i>	7
2.2	<i>Derivative-Related Cross Designation</i>	7
2.3	<i>Bypass Order Marker</i>	8
3.	Technological Implications and Implementation Plan.....	9
3.1	<i>Stakeholders</i>	9
3.2	<i>IIROC</i>	9
4.	Questions	9
5.	Policy Development Process.....	10
5.1	<i>Regulatory Purpose</i>	10
5.2	<i>Regulatory Process</i>	10
	Appendix A – Proposed UMIR Amendments	11
	Appendix B – Text of UMIR to Reflect Proposed UMIR Amendments Respecting Designations and Identifiers	13



1. Discussion of Proposed Amendments

All orders entered on a marketplace must contain the appropriate order designations.¹ As well, Participants must record all applicable order designations required under section 6.2 of UMIR when they receive or create an order.² The Proposed Amendments would supplement these designation requirements.

1.1 Bundled Order Designation

A bundled order includes a combination of client, non-client and/or inventory orders. Currently, a bundled order must be marked with the most restrictive applicable order designation. This ensures that orders are not intentionally bundled to avoid marking an order with the most restrictive applicable marker.

For example, a bundled order containing a combination of principal, client and non-client orders must be marked with the principal accounts marker (the “IN” marker). However, once the bundled order is executed, a Participant or Access Person must submit a report that correctly identifies the client portion of the trade (“Corrections Report”). The report is submitted using the Regulatory Marker Corrections System and must be done by no later than 5 p.m. on the trading day after the aggregate allocation to the client portion of the order is known.³

The Proposed Amendments would add:

- a definition of “bundled order” to section 1.1 of UMIR to mean “an order that includes a client order as well as a non-client order or principal order, or both”
- a bundled order designation to section 6.2 of UMIR.

The bundled order designation could be applied to orders entered on behalf of client and inventory or non-client account types and eliminate the necessity to file a Corrections Report (except to the extent that the client portion of the bundled order is an insider or significant shareholder as defined in UMIR, or where the bundled order is composed of sales from long and short positions and/or from an account that is eligible to use the short-marking exempt designation). The bundled order designation could also be used for orders from managed accounts where the beneficial clients are a mix of both clients and non-clients.

¹ Section 6.2 of UMIR

² Section 10.11 of UMIR

³ See IIROC Notice 08-0033– Guidance Note – UMIR – *New Procedures for Order Marker Corrections* (July 15, 2008).



We would require Participants to provide the “unbundled” client allocation of the trade upon request to ensure that we maintain access to such information when necessary.

1.2 Derivative-Related Cross Designation

Pursuant to section 6.4 of UMIR, each trade that involves a change of beneficial and economic ownership must be executed on a marketplace, unless it falls into one of the enumerated exceptions to the general rule. However, some trades printed on a marketplace, such as derivative-related cross transactions, involve little or no economic transfer of risk.

Certain industry participants have expressed concern that derivative-related cross transactions do not have adequate transparency and suggested that these transactions should be publicly flagged, similar to the identification of intentional crosses and internal crosses. Derivative-related cross transactions are not open to general market participation as they are pre-arranged as part of a larger transaction that typically transpires outside of the equity market.

The proposed derivative-related cross designation could identify any of the following types of transactions:

- listed derivatives transactions, such as hedges against listed options or futures, Exchange for Physical (“EFPs”), and index/custom basket swaps
- related security transactions including hedges against exchangeable or convertible debentures, OTC options, swaps and forwards
- same security transactions, including dividend and “repo” type trades.

The Proposed Amendments would add a derivative-related cross designation under section 6.2 of UMIR and include a definition of “derivative-related cross” in section 1.1 of UMIR to mean “a prearranged trade resulting from an order entered on a marketplace by a Participant or Access Person for a particular security that is offset by a trade in a related derivative instrument and involves little or no aggregate risk.” The derivative-related cross designation would be publicly disseminated in the same manner as an intentional or internal cross under current UMIR requirements.

1.3 Bypass Marker Transparency

A Participant can use a bypass order⁴ marker to ensure it only executes against the disclosed volume of orders and avoid executing with undisclosed portions of liquidity when moving the

⁴ UMIR defines a “bypass order” as an order that is:

- (a) part of a designated trade, or
- (b) to satisfy an obligation to fill an order imposed on a Participant or Access Person by any provision of UMIR or a Policy and that is entered on:
- (c) a protected marketplace to execute as against the disclosed volume on that marketplace prior to the execution or cancellation of the balance of the order; or



market. The bypass order marker is currently a public designation which marketplaces provide to information vendors for disclosure on a consolidated market display.⁵

The Proposed Amendments would modify paragraph 6.2(6)(a) of UMIR to change the bypass order designation to a private designation when used for a bypass order that is not part of a designated trade⁶. The marker, when used with a bypass “cross”, would remain public as information leakage of a completed trade is negligible.

The text of the Proposed Amendments is set out in Appendix “A” and a blackline of the changes is set out in Appendix “B”.

2. Analysis

2.1 Bundled Order Designation

While IIROC does not prohibit the bundling of orders, we have generally discouraged this practice to help ensure an accurate audit trail. However, if an order is bundled, we require a Participant or Access Person to mark the bundled order with the most restrictive applicable designation. This ensures that orders are not intentionally bundled to avoid marking an order with the applicable restrictive marker.

Marking bundled orders with the most restrictive applicable designation may result in the “over-reporting” of trades by certain persons and account types. Currently, Participants and Access Persons must use the “IN” order marker to designate bundled orders that include inventory orders as well as non-client or client orders. In addition, they must use the “NC” order marker for orders containing non-client and client orders. We note however, that compliance issues in reporting the allocations of trades executed from bundled orders still occur, and as a result the IN and NC order markers may be used more broadly than as prescribed under section 6.2 of UMIR.

We believe that adding a bundled order designation will help restore the integrity of the IN and NC order marker audit trail while eliminating the need to file a Corrections Report in many cases.

We note that Participants and Access Persons must still file a Corrections Report where:

-
- (d) a marketplace that is not a protected marketplace but that displays orders in a consolidated market display, to execute as against the displayed orders on that marketplace that would have been included in the disclosed volume if that marketplace had been a protected marketplace.

⁵ Paragraph 6.2(6)(a) of UMIR

⁶ UMIR defines a “designated trade” to mean an intentional cross or a pre-arranged trade of a security that would be made at a price that:

- (a) would not be less than the lesser of:
 - (i) 95% of the best bid price, and
 - (ii) 10 trading increments less than the best bid price; and
- (b) Would not be more than the greater of:
 - (i) 105% of the best ask price, and
 - (ii) 10 trading increments more than the best ask price.



- a portion of the bundled order is an insider or significant shareholder as defined in UMIR⁷, or
- the bundled order contains sales from long and short positions and/or from an account that is eligible to use the short-marking exempt designation⁸.

Participants and Access Persons would only be required to provide the “unbundled” allocation upon regulatory request.

2.1.1 Client Priority

It is important to note that the client priority requirement under section 5.3 of UMIR applies when executing a bundled order. This means that a Participant must fill the client portion of the bundled order first, unless an exemption under subsection 5.3(2) of UMIR is applicable.

Section 1300.20 of the Dealer Member Rules provides an exemption for the “managed accounts” of partners, directors, officers and employees or agents of the Dealer Member from client priority in section 29.3A where these accounts are centrally managed with client accounts and participate equally with client accounts when investment decisions are implemented. The rationale for this exemption was outlined in IDA Bulletin #3241, “as the participation of non-client managed accounts is generally minor, the investment decisions are not being made by the employee account holder, who cannot therefore take advantage of client orders, and the separation of non-client accounts makes the implementation of investment decisions unnecessarily complicated.”⁹

2.2 Derivative-Related Cross Designation

Certain industry participants have expressed concerns with respect to the lack of transparency of “derivative-related” cross transactions. We have heard that including derivative-related crosses on the consolidated tape without flagging them may create large cross prints that inflate market share numbers and may exaggerate the true volume in a security. This can further compromise calculations of volume-weighted-average prices (“VWAP”)¹⁰ and benchmarking since these types of crosses cannot be excluded. Any “liquidity inflation” potentially diminishes the benefit of pre- and post-trade analysis and undermines the ability to measure the true quality of execution to the VWAP for the purposes of achieving best execution. Dealers with large amounts of capital can also inflate market share numbers using “riskless” trades as a vehicle for creating large cross prints.

⁷ See IIROC Notice 15-0135 – Guidance Note – UMIR – *Alternative Guidance on “Insider” Order Marking* (June 24, 2015).

⁸ See IIROC Notice 2005-025 – Guidance Note – UMIR – *Bundling orders from a Long and Short Position* (July 27, 2005) and IIROC Notice 12-0300 – Guidance Note – UMIR – *Guidance on “Short Sale” and “Short-Marking Exempt” Order Designations* (October 11, 2012).

⁹ IDA Bulletin #3241 – Amendments to Regulation 1300 regarding Managed Accounts (January 26, 2004) at p4.

¹⁰ As a VWAP trade participates proportionately to market volumes across all prices, it emphasizes volume, not price.



We have also heard that buy-side firms may “tip their hand” by contacting a Participant that has just printed a large trade in a listed security in which the buy-side firm has an interest. Marking a cross as a “derivative-related” cross transaction would help the buy-side firm understand that the transaction was not open to general market participation and reduce its risk of needlessly contacting the Participant.

The Proposed Amendments would add a:

- definition of “derivative-related cross” under section 1.1 of UMIR to mean “a prearranged trade resulting from an order entered on a marketplace by a Participant or Access Person for a particular security that is offset by a trade in a related derivative instrument and involves little or no aggregate risk”¹¹
- derivative-related cross designation to section 6.2 of UMIR that would be publicly disseminated.

2.3 Bypass Order Marker

Part 6 of NI 23-101 *Trading Rules* imposes an obligation to execute against better-priced, protected orders before a trade at an inferior price can be executed. Participants or Access Persons may use a bypass order marker to ignore or “bypass” the undisclosed portions of the volume of an iceberg order and the volume of other orders not included in the disclosed volume and only trade against displayed liquidity. Using a bypass order marker is particularly helpful when a Participant or Access Person “moves the market” for displacement purposes in order to execute a pre-arranged trade or intentional cross. Currently, paragraph 6.2(6)(a) of UMIR requires that each marketplace must disclose the designation for the bypass order marker in the information it provides to information vendors for disclosure in a consolidated market display.

Certain industry participants expressed concern about the potential information leakage that can result from the public display of the bypass order marker. We have heard that using a bypass order marker may signal to others the arrival of a larger trade especially when the bypass order is used for displacement purposes prior to, or at the same time as, a designated trade. Previous IROC Guidance¹² provided that where a bypass order that is part of a

¹¹ A related security is defined under section 1.1 of UMIR as, in respect of a particular security:

- (a) a security which is convertible or exchangeable into the particular security;
- (b) a security into which the particular security is convertible or exchangeable;
- (c) a derivative instrument for which the particular security is the underlying interest;
- (d) a derivative instrument for which the market price varies materially with the market price of the particular security; and
- (e) if the particular security is a derivative instrument, a security which is the underlying interest of the derivative instrument or a significant component of an index which is the underlying interest of the derivative instrument.

¹² See IROC Notice 09-0128 – Guidance Note – UMIR – *Specific Questions Related to the Use of the Bypass Order Marker* (May 1, 2009).



designated trade (i.e. an intentional cross) is executed at the same time as any displacement trade, it will set the last sale price. However, if the execution of the “bypass” intentional cross occurs after the displacement of better-priced visible orders on any marketplace, the “bypass” intentional cross is in effect an “as of” trade and, as such, would not set the last sale price.

To address the above concerns, the Proposed Amendments would only remove the markers of bypass orders that are not part of a designated trade from public view. Markers for bypass orders that are part of a designated trade (i.e. a prearranged trade or intentional cross) would continue to be public. We believe it is appropriate that the bypass “cross” designation remain public in this case as the trade has been completed and the impact of information leakage is negligible. The Proposed Amendments would update paragraph 6.2(6)(a) of UMIR to reflect the disclosure changes in the bypass order marker.

3. Technological Implications and Implementation Plan

3.1 Stakeholders

Participants, marketplaces, data processors and vendors would need to make any required system changes to accommodate the additional designations and the change to the existing bypass order marker. Modifying existing FIX fields or introducing new tags may be required. The implementation period would consider the amount of effort required to implement the Proposed Amendments.

3.2 IIROC

IIROC would need to modify its systems to accommodate the new designations and the change to the bypass order marker. Modifying existing FIX fields or introducing new tags may be required. The implementation period would consider the amount of effort required for IIROC to implement the Proposed Amendments.

If approved, the Proposed Amendments would become effective **90** days following the date of publication of the Notice of Approval.

4. Questions

While we request comment on all aspects of the Proposed Amendments, we specifically request comment on the following questions:

1. What is the scope of work entailed to make the required system changes? Is a 90-day implementation period reasonable?
2. Are there unintended consequences arising from the changing of the bypass order marker that is not part of a designated trade from a public to a private marker?



3. Should bundled orders be required to contain client orders, or would it be helpful to allow for the possibility of bundled orders that consist only of a combination of principal and non-client orders?
4. Are there other riskless or near riskless trades that should be included in the definition of derivatives-related cross?

5. Policy Development Process

5.1 Regulatory Purpose

The Proposed Amendments would:

- 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, and
- promote just and equitable principles of trade and the duty to act fairly, honestly and in good faith.

5.2 Regulatory Process

The Board of Directors of IIROC (“Board”) has determined the Proposed Amendments to be in the public interest and on May 18, 2016 and approved them for public comment.

MRAC reviewed the Proposed Amendments prior to their consideration by the Board. MRAC is an advisory committee comprised of representatives of each of: the marketplaces for which IIROC acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community.

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, IIROC may recommend that revisions be made to the applicable proposed amendments. If the revisions are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the applicable proposed amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions are material, the applicable proposed amendments as revised will be submitted to the Board for approval for republication.



Appendix A – Proposed UMIR Amendments

The Universal Market Integrity Rules are hereby amended as follows:

1. Section 1.1 is amended by:
 - a. adding the following definition of “bundled order”:

“**bundled order**” means an order that includes a client order as well as a non-client order or principal order, or both.
 - b. adding the following definition of “derivative-related cross”:

“**derivative-related cross**” means a prearranged trade resulting from an order entered on a marketplace by a Participant or Access Person for a particular security that is offset by a trade in a related derivative instrument and involves little or no aggregate risk.
2. Paragraph 6.2(1)(b) is amended by:
 - a. adding the following after subparagraph (vii):

(viii) a derivative-related cross,
 - b. replacing “(viii)” in subparagraph (viii) with “(ix)”
 - c. replacing “(ix)” in subparagraph (ix) with “(x)”
 - d. replacing “(x)” in subparagraph (x) with “(xi)”
 - e. replacing “(xi)” in subparagraph (xi) with “(xii)”
 - f. replacing “(xii)” in subparagraph (xii) with “(xiii)”
 - g. replacing “(xiii)” in subparagraph (xiii) with “(xiv)”
 - h. replacing “(xiv)” in subparagraph (xiv) with “(xv)”
 - i. replacing “(xv)” in subparagraph (xv) with “(xvi)”
 - j. deleting “or” at the end of subparagraph (xv)
 - k. replacing “(xvi)” in subparagraph (xvi) with “(xvii)”
 - l. replacing “.” at the end of subparagraph (xvi) with “, or”
 - m. adding the following after subparagraph (xvi):

(xviii) a bundled order.



3. Subparagraph 6.2(6)(a) is amended by:
 - a. replacing “(vii)” after “sub-clause (i) to” with “(viii)”
 - b. replacing “;” after “clause (1)(b)” with “,”
 - c. adding “but for a bypass order that is not part of a designated trade,” after “inclusive of clause (1)(b)” and before “and”
4. Subparagraph 6.2(6)(b) is amended by:
 - a. replacing “(viii)” after “by sub-clause” with “(ix)”
 - b. replacing “(xvi)” after “sub-clause (viii) to” with “(xviii)”



Appendix B – Text of UMIR to Reflect Proposed UMIR Amendments Respecting Designations and Identifiers

Text of Provision Following Adoption of the Proposed UMIR Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed UMIR Amendments
<p>1.1 Definitions</p> <p>“bundled order” means an order that includes a client order as well as a non-client order or principal order, or both.</p>	<p>1.1 Definitions</p> <p>“bundled order” means an order that includes a client order as well as a non-client order or principal order, or both.</p>
<p>1.1 Definitions</p> <p>“derivative-related cross” means a prearranged trade resulting from an order entered on a marketplace by a Participant or Access Person for a particular security that is offset by a trade in a related derivative instrument and involves little or no aggregate risk.</p>	<p>1.1 Definitions</p> <p>“derivative-related cross” a prearranged trade resulting from an order entered on a marketplace by a Participant or Access Person for a particular security that is offset by a trade in a related derivative instrument and involves little or no aggregate risk.</p>
<p>6.2 Designations and Identifiers</p> <p>(1) Each order entered on a marketplace shall contain:</p> <p>...</p> <p>(b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is:</p> <ul style="list-style-type: none"> (i) a Call Market Order, (ii) an Opening Order, (iii) a Market-on-Close Order, (iv) a Special Terms Order, (v) a Volume-Weighted Average Price Order, (v.1) a Basis Order, (v.2) a Closing Price Order, (v.3) a bypass order, (v.4) a directed action order as defined in the Trading Rules, (vi) part of a Program Trade, (vii) part of an intentional cross or internal cross, (viii) a derivative-related cross, (ix) a short sale but not including an order which is designated as a “short-marking exempt order” in accordance with subclause 6.2(1)(b)(ix), (x) a short-marking exempt order, (xi) a non-client order, (xii) a principal order, (xiii) a jitney order, (xiv) for the account of a derivatives market maker, (xv) for the account of a person who is an insider of the issuer of the security which is the subject of the order, (xvi) for the account of a person who is a significant shareholder of the issuer of the security which is the subject of the order, (xvii) of a type for which the Market Regulator may from time to time require a specific or particular designation, or (xviii) a bundled order. 	<p>6.2 Designations and Identifiers</p> <p>(1) Each order entered on a marketplace shall contain:</p> <p>...</p> <p>(b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is:</p> <ul style="list-style-type: none"> (i) a Call Market Order, (ii) an Opening Order, (iii) a Market-on-Close Order, (iv) a Special Terms Order, (v) a Volume-Weighted Average Price Order, (v.1) a Basis Order, (v.2) a Closing Price Order, (v.3) a bypass order, (v.4) a directed action order as defined in the Trading Rules, (vi) part of a Program Trade, (vii) part of an intentional cross or internal cross, <u>(viii) a derivative-related cross,</u> (viii) (ix) a short sale but not including an order which is designated as a “short-marking exempt order” in accordance with subclause 6.2(1)(b)(ix), (ix) (x) a short-marking exempt order, (x) (xi) a non-client order, (xi) (xii) a principal order, (xii) (xiii) a jitney order, (xiii) (xiv) for the account of a derivatives market maker, (xiv) (xv) for the account of a person who is an insider of the issuer of the security which is the subject of the order, (xv) (xvi) for the account of a person who is a significant shareholder of the issuer of the security which is the subject of the order, or (xvi) (xvii) of a type for which the Market Regulator may from time to time require a specific or particular designation, <u>or</u> (xvii) <u>a bundled order.</u>



Text of Provision Following Adoption of the Proposed UMIR Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed UMIR Amendments
<p>6.2 Designations and Identifiers</p> <p>...</p> <p>(6) Unless otherwise permitted or directed by the Market Regulator, a marketplace shall:</p> <p>(a) disclose for display in a consolidated market display any designation attached to an order that is required by sub-clause (i) to (viii) inclusive of clause (1)(b), but for a bypass order that is not part of a designated trade, and</p> <p>(b) not disclose for display in a consolidated market display any designation attached to an order that is required by sub-clause (ix) to (xviii) inclusive of clause (1)(b).</p>	<p>6.2 Designations and Identifiers</p> <p>...</p> <p>(6) Unless otherwise permitted or directed by the Market Regulator, a marketplace shall:</p> <p>(a) disclose for display in a consolidated market display any designation attached to an order that is required by sub-clause (i) to (vii) (viii) inclusive of clause (1)(b)), but for a bypass order that is not part of a designated trade, and</p> <p>(b) not disclose for display in a consolidated market display any designation attached to an order that is required by sub-clause (viii) (ix) to (xvii) (xviii) inclusive of clause (1)(b).</p>