



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

www.iiac.ca

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Delivered Via Email: tlam@iiroc.ca; marketregulation@osc.gov.on.ca

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Market Regulation
Ontario Securities Commission
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Toronto, Ontario M5H 3S8

Dear Ms. Lam and OSC Market Regulation,

**Re: Investment Industry Regulatory Organization of Canada – Proposed Amendments
Respecting the Trading of Derivatives on a Marketplace**

The Investment Industry Association of Canada (the "IIAC") and its members would like to take this opportunity to express their views on the proposed amendments (the "Proposal") of the Investment Industry Regulatory Organization of Canada ("IIROC") regarding the trading of derivatives on a marketplace as per IIROC Notice 20-0202 (the "Notice") published on October 8, 2020.

The IIAC is the national association representing the position of 115 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

Position of the Industry

The IIAC and its members welcome the possibility of new derivatives marketplaces in the Canadian ecosystem. We believe that competition will strengthen our derivatives market and bring more credibility to our regulatory framework. We have welcomed presentations from the potential new marketplaces, and appreciate the transparency from IIROC with respect to their related initiatives.

As such, the IIAC and its members support IIROC's initiative in modifying its Universal Market Integrity Rules (UMIR) to include derivatives.

Furthermore, we believe that, since derivatives derive their value from an underlying product, market integrity would be better supported by having the newly listed derivatives under the same oversight as their underlying product where possible. We believe that a single oversight for both types of products (derivatives and underlying) would bring increased credibility to our Canadian market.

We also believe it is in the best interest of investors that UMIR is amended to consider derivatives trading. We do, however, want to stress the need for a harmonization of rules with other derivatives marketplaces in Canada to prevent inefficiencies in the Canadian derivatives market.

We note that the IIAC previously submitted a comment letter, dated February 19, 2020, regarding IIROC's Derivatives Modernization Proposal. We encourage IIROC to review those comments where relevant to this framework.

Objectives of the Proposal

IIROC states that "the objective of the Proposed Amendments is to ensure IIROC requirements provide an appropriate framework for the regulation of listed derivatives trading on a marketplace that strengthens market integrity and investor protection". The IIAC and its members agree with IIROC's stated objective.

Notice Introduction and Background

The Notice states:

Prior to the inception of one of IIROC's predecessor organizations, Market Regulation Services Inc. (RS), each exchange regulated trading on its own marketplace with its own set of market integrity rules. RS introduced UMIR as a common set of trading rules designed to bring a consistent approach to the regulation of listed securities trading and help ensure fairness and market integrity in order to strengthen investor confidence. More specifically, UMIR regulates various securities trading practices, including manipulative or deceptive methods of trading, short selling, frontrunning, order entry, as well as trading halts, delays and suspensions. While UMIR functions as IIROC's market integrity rules for the trading of listed securities, it does not currently provide a framework for the regulation of listed derivatives trading.

IIROC is publishing for comment the Proposed Amendments to provide for such a framework and to support IIROC acting as an RSP [regulation services provider] for a derivatives exchange.

Under its Recognition Order, IIROC must establish and maintain rules that, amongst other things, are designed to prevent fraudulent and manipulative acts and practices. We believe the Proposed Amendments provide the fundamental tools IIROC needs to ensure investor protection by effectively deterring or preventing market manipulation of listed derivatives or any other disruption to market integrity through market surveillance, compliance, and enforcement practices and procedures.

We believe that the proposed framework does indeed “ensure fairness and market integrity in order to strengthen investor confidence”; it also strengthens industry participant confidence in this way.

Question # 1

Do you agree with the two-phased approach and with the rule provisions included in each phase as set out in appendices B, C and D?

The IIAC and its members agree with IIROC's two-phased approach. We note that “the Proposed Amendments in Phase 1 are designed to provide a framework for the regulation of *options trading* [emphasis added] on a derivatives exchange for which IIROC acts as the RSP”, and would not relate to other derivatives products.

We believe that Phase 1 represents the most important portion of the possible amendments: market integrity and related provisions.

The IIAC has often made public its concerns regarding market integrity. We therefore believe that IIROC is concentrating its efforts in the right place. However, due to the COVID-19 pandemic, it may have been helpful to provide a few smaller proposals for Phase 1, rather than just one larger/longer proposal covering all topics in Phase 1.

We also note that, though all Phase 2 topics will be analyzed, not all of these topics should conclude with rules in the IIROC rulebook. We believe that some topics, such as product-related rules, should be drafted by the marketplace itself.

Definition of “derivative”, “listed derivative” and “security”

No comments at this time.

Question # 2

Do the proposed changes clearly and sufficiently differentiate between securities and derivatives?

No comments at this time.

2.3. Manipulative and Deceptive Activities

The IIAC and its members strongly believe that potentially manipulative and deceptive activities taking place on the Canadian market must be identified and analyzed by knowledgeable regulatory staff. Manipulative and deceptive activities must be prevented in order to ensure the integrity of the markets and preserve both investor and industry participant confidence in the markets.

Question # 3

Are there any provisions in UMIR 2.2 or Policy 2.2 that should not apply to listed derivatives?

No comments at this time.

Question # 4

Are there other examples of manipulative or deceptive activities that are specific to listed derivatives that we should add to Part 2 of Policy 2.2?

The list of prohibitions regarding derivatives trading should be consistent with practices on other marketplaces that trade listed derivatives. We believe that in order to prevent inefficiencies on Canadian marketplaces, rules on manipulative or deceptive activities should be harmonized with other domestic marketplaces.

2.4. Frontrunning

Question # 5

Do you agree the prohibition on frontrunning, and related pre-hedging exemption, should be extended to derivatives?

The IIAC and its members agree that the prohibition on frontrunning should be extended to derivatives.

We also agree with the pre-hedging exemption as explained in the Notice:

The Proposed Amendments would not prohibit the practice of pre-hedging, which is currently exempted under UMIR 4.1(2)(d). The extension of the prohibition under UMIR 4.1 would be consistent with the regulation of listed derivatives on other exchanges, which similarly prevent dealers from taking advantage of knowledge of non-public information of a client order.

As previously mentioned, we believe that rules on manipulative or deceptive activities should be harmonized in Canada.

2.5. Designations and Identifiers

We appreciate that, where possible, IIROC has extended the various designations and identification requirements used for listed securities to derivatives transactions. This will assist members in their understanding and implementation of these new requirements for derivatives. Nonetheless, it will require additional development and input from members.

Our members are currently preoccupied with meeting the July 26, 2021 reporting requirements that will take effect for listed securities. Members therefore do not have the capacity to handle additional developments with respect to derivatives at this time.

We request assurance from IIROC that members will be provided ample time following the July 26, 2021 deadline, to develop the necessary systems and process changes before IIROC's designation and identifier requirements for derivatives become effective.

Respectfully, we believe it is beyond the scope of this IIAC response letter to review in detail the adequacy of the proposed new designation and identifier requirements related to derivatives. We recommend that IIROC undertakes further industry consultation in this regard.

Question # 6

What would be an appropriate order threshold for determining an “active” OEO client for listed derivatives? What criteria should we consider in determining an “active” OEO client for listed derivatives?

No comments at this time.

2.9. Position Limits and Reporting Limits

The IIAC and its members believe that position and reporting limits should be the responsibilities of marketplaces.

Further questioning from the Industry

Appendix E - “Impact Assessment” contains a double negative. The Notice states: “The Proposed Amendments will not have any impact on Dealer Members that would not trade on a derivatives

exchange for which IIROC is the RSP, including those that currently trade on the Montreal Exchange.” We believe this statement means:

- there is impact if a firm trades derivatives on a marketplace where IIROC is the RSP;
- there is no impact if a firm trades derivatives on the Montréal Exchange;
- there is no impact if a firm does not trade derivatives.

Please let us know if we are misunderstanding the Notice.

Proposed Implementation Dates

The Notice mentions that the “proposed implementation date for the Proposed Amendments would be at least 90 days after the publication of the Notice of Approval”. We believe that the implementation will require significantly more than 90 days to implement.

We may provide additional comments at a later date.

Conclusion

The IIAC and its members generally agree with the Proposal. However, we believe that, for the stated purpose of the Proposal to be achieved, IIROC needs to harmonize its derivatives rules with those of the current derivatives exchange in Canada (Montréal Exchange).

We also believe that product-related rules like position limits and reporting limits, must remain at the exchange level.

Please note that the IIAC and its members, as always, remain available for further consultations.

Yours sincerely,



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