

IIROC NOTICE

Rules Notice
Request for Comments
UMIR

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Comments Due By: March 15, 2019

Contact:

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18-0231

December 13, 2018

Proposed Amendments Respecting Provision of Price Improvement by a Dark Order

Executive Summary

IIROC is proposing amendments (**Proposed Amendments**) to UMIR that would modify the requirements for Dark Orders¹ to provide a better price² when trading against certain orders (**Dark**

¹ "Dark Order" means:

- (a) an order no portion of which is displayed on entry on a marketplace in a consolidated market display; or
- (b) that portion of an order which on entry to a marketplace is not displayed in a consolidated market display if that portion may trade at a price other than the price displayed by that portion of the order included in the consolidated market display

but does not include an order entered on a marketplace as:

- (c) part of an intentional cross;
- (d) a market order that is immediately executed in full on one or more marketplaces at the time of entry;
- (e) a limit order that is immediately executed in full on one or more marketplaces at the time of entry;
- (f) a Basis Order;
- (g) a Call Market Order if that Call Market Order may only trade with other Call Market Orders and the matching of Call Market Orders occurs less frequently than once every minute;
- (h) a Closing Price Order;
- (i) a Market-on-Close Order;
- (j) an Opening Order; or
- (k) a Volume-Weighted Average Price Order.

² "better price" means, in respect of each trade resulting from an order for a particular security:

- (a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and
- (b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a



Order Requirements). We implemented the Dark Order Requirements to allow trading in the dark while still preserving price discovery. This is accomplished by requiring a Dark Order to provide a better price when trading against “small”³, active orders that would otherwise execute against displayed orders.

We reviewed the thresholds used to capture “small” orders in the Dark Order Requirements and found that orders for low-priced securities (i.e. securities priced at \$0.10 or below) with low notional values disproportionately do not receive a better price than higher-priced securities.

We believe that this result is inconsistent with the policy objectives of the Dark Order Requirements and are therefore proposing a minimum dollar value threshold that would be tied to the current minimum volume threshold of 50 standard trading units (**STUs**). We are of the view that the combination of both a minimum dollar value **and** a minimum volume will better capture small orders, especially those in low-priced securities.

Specifically, the Proposed Amendments would add a minimum order value of \$30,000 in addition to the current threshold of 50 STUs. Therefore, an order would be able to execute against a Dark Order without receiving a better price only if it is sufficiently large in both volume (over 50 STUs) and value (over \$30,000).

Impacts

If implemented, Participants, marketplaces and other stakeholders would need to make necessary technology changes to ensure that orders with a notional value of less than \$30,000 do not trade against a Dark Order unless the order receives a better price.

If approved, the Proposed Amendments would become effective no less than **90** days after publication of the notice of approval.

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 **March 15, 2019** to:

Sanka Kasturiarachchi,
Policy Counsel, Market Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000
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marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.

³ A “small order” is considered to be 50 standard trading units or less, which is 5,000 units of a security trading at \$1.00 or more per unit, 25,000 units of a security trading at \$0.10 or more per unit and less than \$1.00 and 50,000 units when a security is trading at less than \$0.10 per unit – IIROC Rules Notice [12-0130](#) – Notice of Approval – UMIR – Provisions Respecting Dark Liquidity (April 13, 2012) pg. 7



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e-mail: skasturiarachchi@iroc.ca

A copy should also be provided to the CSA by forwarding a copy to:

Market Regulation
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, Ontario M5H 3S8
Fax: (416) 595-8940
e-mail: 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.



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1. Description of Proposed Amendments

The Proposed Amendments would modify the Dark Order Requirements. Currently, orders that are greater than 50 STUs or have a value of more than \$100,000 may execute with a Dark Order at the best bid or best ask price⁴. Any order below these thresholds must execute at a better price when trading with a Dark Order⁵.

Some market stakeholders have expressed concern that these current thresholds, when applied to low-priced securities, allow orders of a small notional value to trade without price improvement and therefore do not meet the intended policy objectives of the Dark Order Requirements. We reviewed historical trading data to determine whether any changes were necessary to achieve our intended policy objectives. Our analysis revealed that the current 50 STUs threshold alone does not effectively identify small orders of low-priced securities and therefore does not adequately meet the policy objective of the Dark Order Requirements to preserve price discovery.

Since the 50 STUs threshold by itself does not effectively identify small orders of low-priced securities, we are proposing to tie a minimum order value with the 50 STUs threshold to address this issue. In addition to being greater than 50 STUs, an order would also need to exceed a minimum order value to execute against a Dark Order without receiving a better price. Specifically, we are proposing to add a minimum dollar value of \$30,000 to UMIR Rule 6.6 that would be tied to the current minimum volume threshold of 50 STUs. The current \$100,000 upper-value threshold would remain. As a result of this change, for an order not to receive a better price when executing against a Dark Order, it would need to have:

- both a volume greater than 50 STUs **and a value greater than \$30,000**, or
- a value of greater than \$100,000.

Therefore, an order that has a volume greater than 50 STUs but has a value of less than \$30,000 would require a better price when trading against a Dark Order.

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

⁴ “Best bid price” is defined in UMIR as the highest price of an order on any protected marketplace as displayed in a consolidated market display to buy a particular security, but does not include the price of any order that is a Basis Order, Call Market Order, Closing Price Order, Market-on-Close Order, Opening Order, Special Terms Order or Volume-Weighted Average Price Order. “Best ask price” is defined in UMIR as the lowest price of an order on any protected marketplace as displayed in a consolidated market display to sell a particular security, but does not include the price of any order that is a Basis Order, Call Market Order, Closing Price Order, Market-on-Close Order, Opening Order, Special Terms Order or Volume-Weighted Average Price Order.

⁵ Section 6.6 of UMIR



2. Analysis

2.1 Review of UMIR Thresholds and Internalization

UMIR uses dollar-value and 50 STUs thresholds in several different rules. We are currently reviewing all of these thresholds to determine if they continue to meet our regulatory objectives. The table below sets out the UMIR provisions (other than the Dark Order Requirements) that contain a 50 STUs and/or a dollar-value threshold.

Threshold	UMIR Rule and application
≤50 STUs	6.3 - Exposure of Client Orders – must immediately display order if it meets or is under the threshold
>\$100,000	6.3 - Exposure of Client Orders – not required to immediately display order if it is over the threshold
>50 STUs or >\$250,000	6.4 - Trades to be on a Marketplace – order may not execute on a FORM ⁶ if <ul style="list-style-type: none"> • it is from a Canadian account denominated in Canadian funds • it would avoid execution against a better-priced order on a marketplace in Canada • it is over the threshold
>50 STUs and >\$100,000	6.4 - Trades to be on a Marketplace – may report trades to an acceptable foreign trade reporting facility if trade is over the threshold

⁶ A foreign organized regulatory market or FORM is defined in UMIR as a market outside of Canada:

- (a) that is an exchange, quotation or trade reporting system, alternative trading system or similar facility recognized by or registered with a securities regulatory authority that is an ordinary member of the International Organization of Securities Commissions;
- (b) on which the entry of orders and the execution or reporting of trades is monitored for compliance with regulatory requirements at the time of entry and execution or reporting by a self-regulatory organization recognized by the securities regulatory authority or by the market if the market has been empowered by the securities regulatory authority to monitor the entry of orders and the execution or reporting of trades on that market for compliance with regulatory requirements; and
- (c) that displays and provides timely information to information vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market of at least the price, volume and security identifier of each trade at the time of execution or reporting of the trade on that market,

but, for greater certainty, does not include a facility of a market to which trades executed over-the-counter are reported unless:

- (d) the trade is required to be reported and is reported to the market forthwith following execution;
- (e) at the time of the report, the trade is monitored for compliance with securities regulatory requirements; and
- (f) at the time of the report, timely information respecting the trade is provided to information vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market.



≤ 50 STUs or ≤ \$100,000	8.1 - Client-Principal Trading – may execute a client order against a principal order or non-client order at a better price provided <ul style="list-style-type: none">• reasonable steps are taken to ensure the price given to the client is the best available under prevailing market conditions• order meets or is under the threshold
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IIROC, together with the CSA, is currently reviewing the practice of internalization to consider how these trading practices fit within our rule framework. Similar to the goal of our UMIR threshold review, our goal of the internalization review is to ensure that our rules continue to meet their intended objectives. We note that some of the UMIR provisions that contain thresholds are intricately connected with the practice of internalization, such as UMIR 6.3 Exposure of Client Orders and UMIR 8.1 Client-Principal Trading. Our review of internalization may show that further changes to the thresholds are required. In light of this possibility, and to ensure we do not introduce more changes than necessary, we are not proposing any threshold changes to the above-cited UMIR provisions until our review of internalization is complete.

2.2 Determination of UMIR STU and Dollar Value Thresholds

When first implemented in the Client Exposure Rule (UMIR 6.3), the thresholds were meant to define what were considered “small” sized orders. At that time, we chose a 5,000-share threshold (equal to 50 STUs for securities that are at or over \$1.00) and a \$100,000 upper-value threshold as they were:

- thought to effectively capture most small orders
- applied to 95% of the trades executed on the TSX⁷.

When considering the appropriate types of thresholds that should be used, we also determined at that time that a dollar-value threshold alone would not be sufficient as this approach would apply a “one-size-fits-all” solution and not recognize the significant differences in the structure of the junior and senior markets⁸. For example, a \$100,000 order for a security priced below a dollar would be significantly larger in volume than a security with a higher value and would not be considered “small”. Therefore the STU threshold, which changes according to the price of a security, was added to address this concern⁹.

Today, the 50 STUs threshold acts to set the lower limit of small orders using share volume as a factor, while the \$100,000 value sets the upper limit of what is considered a small order.

⁷ TSX Regulatory Notice 97-036

⁸ Canadian Securities Administrators Request for Comment 23-401 Proposed Universal Market Integrity Rules of TSE RS and CDNX (2001) 24 OSCB 2555 page 2564

⁹ A full description of how standard trading units are defined is found at Appendix C.



2.3 Policy Objectives of the Dark Order Requirements

Under the current Dark Order Requirements, any order which trades with a Dark Order must receive price improvement unless the order, as entered on the marketplace, is for more than 50 STUs or has a value of more than \$100,000. If the order meets either of these requirements, the order may trade with the Dark Order at the best bid or best offer, provided no displayed orders are available on that marketplace at the best bid or best offer.

The policy objective of this requirement is to preserve price discovery by:

- giving priority to visible orders on a marketplace that are at the same price as Dark Orders on the same marketplace
- ensuring Dark Orders provide a better price to small orders that could otherwise be executed on a transparent marketplace¹⁰. Investors who post transparent orders must have confidence in their ability to execute. Therefore the Dark Order Requirements help to ensure that small orders that otherwise could be executing against displayed liquidity are not executed in dark trading books.

However, the Dark Order Requirements do permit large, active orders to execute against dark liquidity¹¹, without price improvement. This aspect of the rule was designed to accommodate the long-standing practice and important function of dark trading and the “upstairs market” to allow investors to place large orders without displaying them to the public in order to minimize the market impact costs associated with such large orders¹².

2.4 Concerns with Current Dark Order Requirements Threshold

In addition to our review of UMIR thresholds described in section 2.1, our review of the thresholds in the Dark Order Requirements was also conducted in light of concerns expressed by market stakeholders about the appropriateness of the 50 STUs threshold. Specifically they questioned whether the current threshold for low-priced securities continues to meet the policy objectives of the Dark Order Requirements.

Certain stakeholders believe that the proportion of executions on marketplaces that do not display orders in a consolidated market display (**dark marketplace**) against the proportion of executions on a marketplaces that display orders (**lit marketplace**) has increased overtime with a significant increase in securities trading below \$0.10. They argue that, while the share volume of such orders comply with the 50 STUs threshold, these orders have low notional dollar values and the current application of the threshold negatively affects the:

- price discovery of these securities – as the majority of executions taking place on dark marketplaces or with Dark Orders do not contribute to price discovery

¹⁰ IIROC Rules Notice [12-0130](#) – Notice of Approval – UMIR – *Provisions Respecting Dark Liquidity* (April 13, 2012) Pg.12

¹¹ IIROC Rules Notice [12-0130](#) – Notice of Approval – UMIR – *Provisions Respecting Dark Liquidity* (April 13, 2012) Pg.29

¹² [CSA/IIROC Consultation Paper](#) 23-404 *Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada* – Pg. 7878



- execution priority in these securities – as executions on dark marketplaces occur at price levels that overlook visible orders on lit marketplaces that are at the same price levels.

2.5 Description and Results of Review

We reviewed historical trading data comparing dark vs. lit trading of low-priced securities for the periods from April to September (inclusive) of 2016 and 2018. We looked at the change in dark trading in terms of number of trades, volume and value over these periods.

		LIT	DARK
Price Bucket	Aggregate	% Change from April to September (inclusive) of 2016 and 2018	% Change from April to September (inclusive) of 2016 and 2018
< \$ 0.10	Average # of Trades per Month	-13.78%	194.94%
	Average Value per Trade	-12.58%	-11.34%
	Average Volume per Trade	-18.83%	-17.38%
≥ \$ 0.10 and < \$ 1.00	Average # of Trades per Month	38.92%	266.71%
	Average Value per Trade	-8.23%	28.30%
	Average Volume per Trade	-9.35%	53.21%
≥ \$1.00	Average # of Trades per Month	-15.32%	94.24%



Average Value per Trade	18.18%	-3.97%
Average Volume per Trade	0.72%	-12.91%

This analysis reveals that the:

- proportion of executions on dark marketplaces vs. lit marketplaces in low-priced securities has increased significantly since 2016
- average order size and value for low-priced securities traded on dark marketplaces have decreased since 2016.

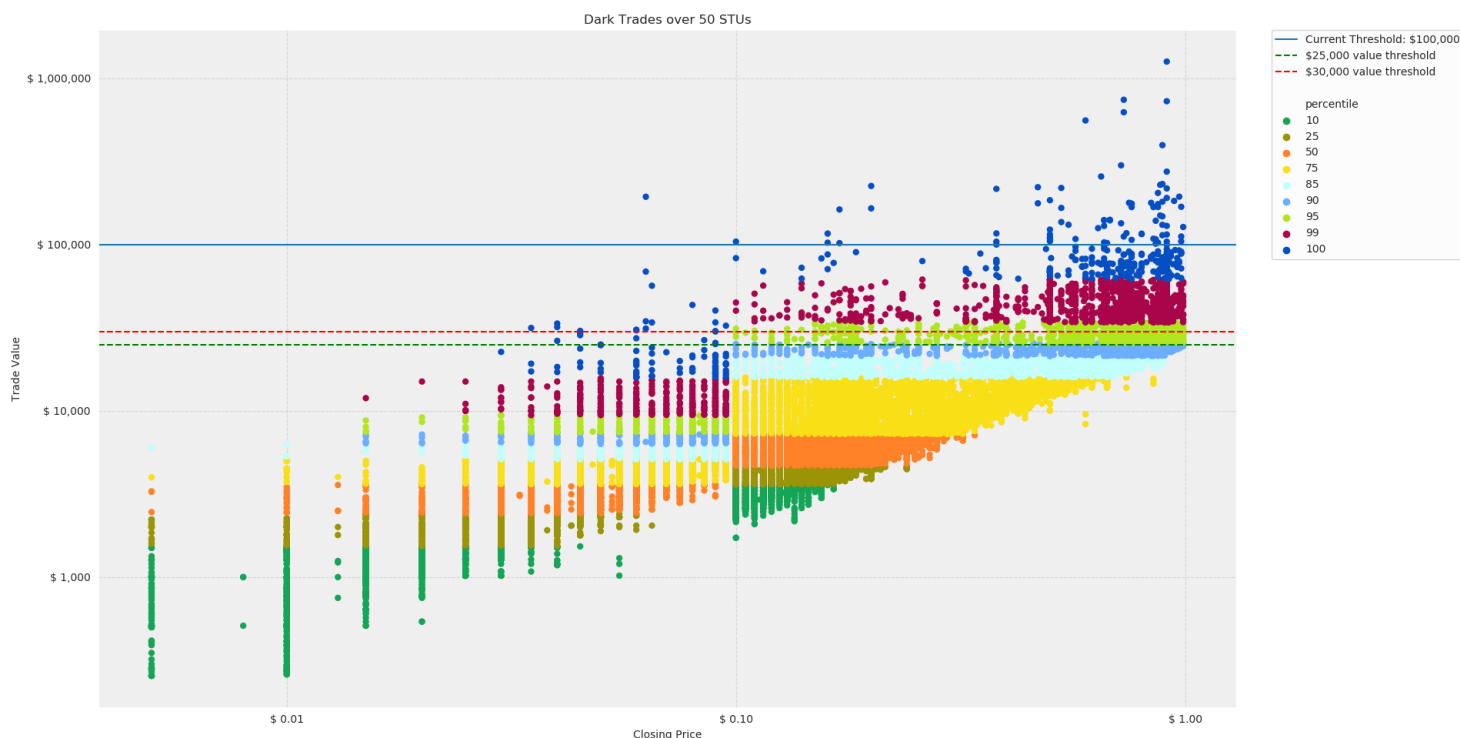
The significant increase in the number of trades for securities trading below \$0.10 together with the decrease in both average volume and value validates some of the concerns raised by stakeholders.

When the Dark Order Requirements were initially implemented, only a small number of low-priced securities were traded in the dark without price improvement but this is no longer the case. The current 50 STUs threshold alone does not effectively capture “small” orders in low-priced securities and therefore does not fully meet the policy objective of the Dark Order Requirements. In order to ensure we are appropriately achieving the policy objective of preserving price discovery, we believe that updating the threshold to better reflect the value of small orders for low-priced securities is necessary.

To determine the appropriate value of small orders that could trade against a Dark Order without receiving a better price we used a scatterplot to see the value of trades based on trade price. We separated the trades in the following price buckets:

- below \$0.10
- between \$0.10 and \$0.99
- above \$1.00.

Each point on the scatterplot below represents a trade. The value of a trade is visualized based on the security price. For each price bucket (i.e. below \$0.10, and between \$0.10 and \$0.99), the trades are color-coded to represent the percentile by value in which they fall. The solid blue line shows the current value threshold of \$100,000. The dashed coloured lines show the value of \$25,000 for comparison purposes and the proposed threshold value of \$30,000 for dark trades over 50 STUs.



The above results show that for securities trading below \$0.10, adding either a \$25,000 or a more aggressive \$30,000 threshold would only allow about the top 1% of orders of these low-priced securities to trade in the dark without receiving a better price. Therefore, this proposed threshold would better capture small orders in low-priced securities and in turn, more effectively meet the policy objectives of the Dark Order Requirements.

2.6 Solutions Considered

IIROC looked at different solutions to most appropriately modify the current thresholds, including:

- using a mathematical function to determine the appropriate price and value that could be used as a benchmark to differentiate small orders from other orders. However, in comparison to the current thresholds, this mathematical function has the disadvantage of being potentially more complex to codify in electronic solutions, and much more complex for human traders to use.
- amending the STU definition by adding the following more granular price buckets:
 - $\geq \$0.05$ and $< \$0.25$
 - $\geq \$0.75$ and $< \$1.25$.

Modifying the current programming code to add two more price buckets for an STU threshold would be quite complex, as we understand that the code for implementing the STU threshold is a legacy code that touches many other programming areas.



- removing the STU threshold and using only a dollar-value threshold across all securities. This is a simpler solution to implement, however, finding the right dollar-value threshold would be difficult due to the wide price range in equity securities. We continue to believe that only using a dollar-value threshold is not sufficient as it would apply a “one-size fits-all approach” and would not recognize the significant differences in the structure of the junior and senior markets.
- adding a minimum dollar value, to be applied along with the existing STU and upper dollar value thresholds. We believe by adding a “floor value” that reflects the average dollar value of a small order across all price levels, along with the existing STU and upper value thresholds to UMIR 6.6 would effectively preserve price discovery.

IIROC is proposing to add a minimum dollar-value threshold of \$30,000 in addition to the minimum 50 STUs volume threshold as we believe it is the least complex solution that effectively meets our policy objectives and should be relatively easy for industry to implement.

3. Technological Implications and Implementation Plan

3.1 Stakeholders

If implemented, Participants, marketplaces and vendors would need to make necessary technology changes to ensure that orders with a notional dollar value of less than \$30,000 do not trade against a Dark Order unless the order receives a better price.

3.2 IIROC

We do not anticipate that the Proposed Amendments would have any technological or other impact on IIROC.

If approved, the Proposed Amendments would become effective no less than **90** days after publication of the notice of approval.

4. Questions

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

1. Will the proposed floor value of \$30,000 adequately capture small orders and address concerns regarding low-priced securities trading in the dark without price improvement? Would a \$25,000 threshold be more appropriate? If so, why?
2. What is the scope of work required to make the appropriate systems changes? Is a 90-day implementation period reasonable?
3. Are there any unintended consequences arising from the proposed inclusion of the \$30,000 threshold in UMIR Rule 6.6?



5. Policy Development Process

5.1 Regulatory Purpose

The Proposed Amendments would:

- add a minimum threshold of \$30,000 to the Dark Order Requirements to better align with the policy objective of preserving price discovery
- promote the protection of investors.

5.2 Regulatory Process

The Board of Directors of IIROC (**Board**) has determined the Proposed Amendments to be in the public interest and on November 28, 2018 approved them for public comment.

The Market Rules Advisory Committee (**MRAC**) of IIROC considered this matter.¹³ 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 revisions to the applicable proposed amendments. If the comments or 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 we receive material comments from the public or the Recognizing Regulators or propose revisions that are material, the applicable proposed amendments as revised will be submitted to the Board for approval. If approved by the Board, any proposed material revisions will be published for comment.

¹³ Consideration by MRAC should not be construed as approval or endorsement of the Proposed Amendments. Members of MRAC are expected to provide their personal advice on topics and that advice may not represent the views of their respective organizations as expressed during the public comment process.



Appendix A – Proposed UMIR Amendments

The Universal Market Integrity Rules are hereby amended as follows:

1. Subsection (1) of Rule 6.6 is amended by:
 - (a) inserting the phrase “and has a value of more than \$30,000” immediately before the phrase “or has a value of more than \$100,000” in subclause (i) of clause (b)
 - (b) inserting the phrase “and has a value of more than \$30,000” immediately before the phrase “or has a value of more than \$100,000” in subclause (i) of clause (c).



Appendix B – Text of UMIR to Reflect Proposed Amendments Respecting Provisions of Price Improvement by a Dark Order

Text of Provision Following Adoption of the Proposed UMIR Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed UMIR Amendments
<p>6.6 Provision of Price Improvement by a Dark Order</p> <p>(1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:</p> <p>(a) at a better price;</p> <p>(b) in the case of a purchase, at the best ask price if:</p> <p style="padding-left: 20px;">(i) the order on entry to the marketplace is for more than 50 standard trading units and has a value of more than \$30,000 or has a value of more than \$100,000, and</p> <p style="padding-left: 20px;">(ii) on the execution of the trade with the Dark Order, no orders for the sale of the security included in the calculation of the best ask price are displayed on that marketplace at that best ask price; or</p> <p>(c) in the case of a sale, at the best bid price if:</p> <p style="padding-left: 20px;">(i) the order on entry to the marketplace is for more than 50 standard trading units and has a value of more than \$30,000 or has a value of more than \$100,000, and</p> <p style="padding-left: 20px;">(ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security included in the calculation of the best bid price are displayed on that</p>	<p>6.6 Provision of Price Improvement by a Dark Order</p> <p>(1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:</p> <p>(a) at a better price;</p> <p>(b) in the case of a purchase, at the best ask price if:</p> <p style="padding-left: 20px;">(i) the order on entry to the marketplace is for more than 50 standard trading units <u>and has a value of more than \$30,000</u> or has a value of more than \$100,000, and</p> <p style="padding-left: 20px;">(ii) on the execution of the trade with the Dark Order, no orders for the sale of the security included in the calculation of the best ask price are displayed on that marketplace at that best ask price; or</p> <p>(c) in the case of a sale, at the best bid price if:</p> <p style="padding-left: 20px;">(i) the order on entry to the marketplace is for more than 50 standard trading units <u>and has a value of more than \$30,000</u> or has a value of more than \$100,000, and</p> <p style="padding-left: 20px;">(ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security included in the calculation of the best bid price are displayed on that</p>



<p>marketplace at that best bid price.</p> <p>(2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:</p> <ul style="list-style-type: none">(a) a Basis Order;(b) a Call Market Order;(c) a Closing Price Order;(d) a Market-on-Close Order;(e) an Opening Order;(f) a Volume-Weighted Average Price Order; or(g) for less than one standard trading unit.	<p>marketplace at that best bid price.</p> <p>(2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:</p> <ul style="list-style-type: none">(a) a Basis Order;(b) a Call Market Order;(c) a Closing Price Order;(d) a Market-on-Close Order;(e) an Opening Order;(f) a Volume-Weighted Average Price Order; or(g) for less than one standard trading unit.
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Appendix C - The STU definition in UMIR

An STU is defined in UMIR as:

in respect of:

- (a) a derivative instrument, 1 contract;
- (b) a debt security that is a listed security or a quoted security, \$1,000 in principal amount; or
- (c) any equity or similar security:
 - (i) 1,000 units of a security trading at less than \$0.10 per unit,
 - (ii) 500 units of a security trading at \$0.10 or more per unit and less than \$1.00 per unit, and
 - (iii) 100 units of a security trading at \$1.00 or more per unit.

The number of shares that constitute 50 STUs (lower value threshold) for an equity or similar security would be:

\$ value per share	50 STU share amount
<0.10	50,000
≥0.10 and <1.00	25,000
≥1.00	5,000