

IIROC NOTICE

Rules Notice Request for Comments

UMIR

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14-0089

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Proposed Guidance on Marketplace Thresholds

Executive Summary

IIROC is requesting comment on proposed guidance (“Proposed Guidance”) that IIROC would issue regarding the establishment and operation of price and volume thresholds by each marketplace in Canada (“Marketplace Thresholds”) which would complement other initiatives undertaken by IIROC for controlling short term, unexplained price volatility and risks arising from electronic trading.

National Instrument 23-103 *Electronic Trading* (“Electronic Trading Rule”), which became effective March 1, 2013, provides that a “marketplace must not permit the execution of orders for exchange-traded securities to exceed the price and volume thresholds” set by IIROC. This Request for Comments is the next step in the public consultation process that will lead to IIROC establishing parameters for Marketplace Thresholds. IIROC previously sought comment on approaches that IIROC might take in connection with establishing such parameters.¹

The Proposed Guidance is based on three guiding principles:

- Marketplace Thresholds should operate to generally preclude the execution of orders at prices that would otherwise, on execution, require regulatory intervention by IIROC

¹ IIROC Notice 12-0162 – Rules Notice – Request for Comments – UMIR – *Request for Comments on Marketplace Thresholds* (May 10, 2012). A summary of the comments received and IIROC’s response to the comments is attached to this notice as Appendix B.



on the triggering of a Single-Stock Circuit Breaker² (“SSCB”) or the application of IIROC’s policies and procedures for the variation and cancellation of trades (“Unreasonable Trade Policy”).³

- The volatility control mechanism used by a marketplace should have the least amount of impact that is practical on the market-wide operation of the price discovery mechanism and access to “tradable” liquidity.
- The introduction or amendment of Marketplace Thresholds by a marketplace should, to the greatest extent possible, not impose a regulatory burden (including the need for technological changes) on other marketplaces or on service providers, regulation services providers, information processors, Participants and Access Persons.

In addition, the Proposed Guidance would confirm that Marketplace Thresholds:

- need not include controls on the volume of a trade that would not unduly impact the market price;
- would only be required on “protected marketplaces”;
- should apply to all orders that, on execution, would be able to set the “last sale price”;
- regardless of the functionality used, should not preclude the operation of a Market-on-Close facility or the eligibility of the particular security to trade on the marketplace pursuant to a Closing Price Order;
- should apply to an order received by a marketplace as a “directed-action order”; and
- should be publicly disclosed (at least on the website of the marketplace as to the functionality of the Marketplace Thresholds).

The Proposed Guidance would establish a framework for each marketplace to adopt Marketplace Thresholds that are appropriate for the type of trading on that marketplace. The Proposed Guidance does not prescribe levels of price movement at which the Marketplace Thresholds must preclude trading activity other than the requirement that they operate to generally preclude the execution of orders at prices that would otherwise trigger regulatory intervention by IIROC.

After considering the comments received in response to this Request for Comments, together with any comments of the Recognizing Regulators, IIROC will issue guidance on the parameters for the establishment of Marketplace Thresholds which will become effective on a date that is **at least** 180 days following the publication of the notice.

² For details on the current operation of Single-Stock Circuit Breakers, see IIROC Notice 12-0040 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Implementation of Single-Stock Circuit Breakers* (February 2, 2012). See also IIROC Notice 13-0298 – Rules Notice – Request for Comments – UMIR – *Proposed Guidance Respecting the Extension of Single-Stock Circuit Breakers* (December 11, 2013).

³ IIROC Notice 12-0258 - Rule Notice – Guidance Note – UMIR - *Guidance on Regulatory Intervention for the Variation or Cancellation of Trades* (August 20, 2012).



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1. Policy Development Process

IIROC has been recognized as a self-regulatory organization by each of the Canadian provincial securities regulatory authorities (the “Recognized Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 (“Marketplace Operation Instrument”) and National instrument 23-101.

As a regulation services provider, IIROC administers and enforces trading rules for the marketplaces that retain the services of IIROC.⁴ IIROC has adopted, and the Recognizing Regulators have approved, UMIR as the market integrity trading rules that will apply in any marketplace that retains IIROC as its regulation services provider.

The Market Rules Advisory Committee (“MRAC”) of IIROC was consulted with respect to the subject of Marketplace Thresholds generally and this Request for Comments in particular. 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.⁵

Comments are requested on all aspects of Marketplace Thresholds, including any matter not addressed in this Request for Comments. Comments should be in writing and delivered by **July 3, 2014** to:

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Comment letters will be made publicly available on the IIROC website (www.iiroc.ca under the heading “Notices” and sub-headings “Marketplace Rules – Request for Comments”) upon receipt. A summary of the comments contained in each submission will also be included in a future IIROC Notice.

⁴ Presently, IIROC has been retained to be the regulation services provider for: Alpha Exchange Inc. (“Alpha”), Canadian Securities Exchange (“CSE”), Toronto Stock Exchange (“TSX”) and TSX Venture Exchange (“TSXV”), each as an “exchange” for the purposes of the Marketplace Operation Instrument (“Exchange”); and for Bloomberg Tradebook Canada Company (“Bloomberg”), Chi-X Canada ATS Limited (which operates “Chi-X” and “CX2”), Instinet Canada Cross Ltd. (“Instinet”), Liquidnet Canada Inc. (“Liquidnet”), Omega ATS Limited (“Omega”), TMX Select (“TMX Select”) and TriAct Canada Marketplace LP (the operator of “MATCH Now”), each as an alternative trading system (“ATS”).

⁵ The review by MRAC of the Proposed Guidance should not be construed as approval or endorsement of the Proposed Guidance. Members of MRAC may express their personal views on topics and that advice may not represent the views of their respective organizations as expressed during the public comment process.



After considering the comments received in response to this Request for Comments, together with any comments of the Recognizing Regulators, IIROC will issue final guidance on the establishment of parameters for Marketplace Thresholds (“Guidance”).

2. Background to the Proposed Guidance

2.1. Controlling Unexplained Price Volatility

Marketplace Thresholds are intended to operate as part of a four-level approach to controlling short term, unexplained price volatility. Each set of controls will ultimately play an important role in the overall framework designed to mitigate the risks associated with “unexplained short term price movement” and promote “fair and orderly markets” in an electronic trading context. The four identified levels of control are:

- at the level of Participant or Access Person entering orders on a marketplace;
- at the marketplace level with each of the marketplaces expected to have effective thresholds in place that would, in the ordinary course, detect “erroneous” or “unreasonable” orders prior to execution;
- the application of SSCBs or regulatory intervention by IIROC, which are designed to halt trading in the event of rapid and unexplained price movement over a short period of time; and
- Market-wide Circuit Breakers which would trigger and halt trading on all marketplaces when there are declines in prices which affect the market generally.

Given the “tiered” nature of these controls, the content of the requirements at each level must be coordinated to ensure that there are no readily identifiable gaps and that each set of controls is capable of working effectively in conjunction with the other levels. Market integrity requires that there be a “fair and orderly market” in the trading of all listed and quoted securities. Notwithstanding the introduction of SSCBs and the other level of “controls”, IIROC retains the discretionary power to intervene, if required, to ensure a “fair and orderly market” in the trading of a listed security.

2.2. Obligations of Participants and Access Persons

Under UMIR, an order may only be entered on a marketplace by or through a Participant or Access Person. UMIR and applicable securities legislation impose various obligations on a Participant or Access Person prior to the entry of an order to a marketplace.

Rule 7.1 and Policy 7.1 of UMIR establish and explain the responsibility of Participants for trading supervision and compliance, and certain elements of Policy 7.1 relate particularly to



electronic trading. Specifically, the obligation to supervise applies whether the order is entered on a marketplace:

- by a trader employed by the Participant;
- by an employee of the Participant through an order routing system;
- directly by a client and routed to a marketplace through the trading system of the Participant; or
- by any other means.

Effective March 1, 2013, Part 7 of Policy 7.1 was added to align the UMIR requirements with the *Electronic Trading Rule*.⁶ Part 7 details the expectations in regard to the elements of the risk management and supervisory controls, policies and procedures that must be employed by Participants and Access Persons,⁷ which must include:

- automated controls to examine each order before entry on a marketplace to prevent the entry of an order which would result in:
 - o the Participant or Access Person exceeding pre-determined credit or capital thresholds,
 - o a client of the Participant exceeding pre-determined credit or other limits assigned by the Participant to that client, or
 - o the Participant, Access Person or client of the Participant exceeding pre-determined limits on the value or volume of unexecuted orders for a particular security or class of securities; and
- provisions to prevent the entry of an order that is not in compliance with Requirements.

“Requirements” include UMIR, applicable securities regulation, requirements of any self-regulatory organization applicable to the activity of the account and the rules and policies of any marketplace on which the account activity takes place. Under Part 8 of Policy 7.1 a Participant or Access Person that uses an automated order system must have appropriate parameters, policies and procedures to detect, prior to entry, an order that is “clearly erroneous” or “unreasonable” and which would interfere with fair and orderly markets if entered. In particular, the specific provisions of the policy applicable to automated order systems provide:

⁶ Notice of National Instrument 23-103 – *Electronic Trading*, (2012) 35 OSCB 6037 (June 28, 2012).

⁷ See IIROC Notice 12-0363 – Rules Notice – Notice of Approval – UMIR – *Provisions Respecting Electronic Trading* (December 7, 2012) and the associated guidance in IIROC Notice 12-0364 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting Electronic Trading* (December 7, 2012).



The scope of appropriate order and trade parameters, policies and procedures should be tailored to the strategy or strategies being pursued by an automated order system with due consideration to the potential market impact of defining such parameters too broadly and in any event must be set so as not to exceed the marketplace thresholds applicable to the marketplace on which the order is entered or would otherwise exceed the limits publicly disclosed by the Market Regulator for the exercise of the power of a Market Integrity Official under Rule 10.9 of UMIR.

To date, IIROC has publicly disclosed limits for regulatory intervention pursuant to SSCBs or the Unreasonable Trade Policy. The requirement in Part 8 of Policy 7.1 does not require that the parameters used by the automated order system be calculated in exactly the same manner as IIROC determines the trigger point of SSCBs or marketplaces will determine the application of their Marketplace Thresholds. Generally speaking, a SSCB will trigger if the price of a security covered by the program experiences price movement of at least 10% in a five-minute period. As set out in the Proposed Guidance, Marketplace Thresholds would be expected to operate “to generally preclude the execution of orders at prices” that would otherwise trigger a SSCB. Therefore, it would not be acceptable for the parameter of an automated order system to be set to allow price movement of 10% or more from the last sale price or the best bid price/best ask price as price movement of this magnitude would be expected to trigger one or both of a Marketplace Threshold and SSCB.

The Proposed Guidance would require each marketplace to provide public transparency of the functionality of its Marketplace Thresholds. However, the Proposed Guidance would confirm that IIROC does not expect that disclosure will necessarily allow Participants and Access Persons to determine with accuracy when the Marketplace Thresholds would be reached for an individual security at a particular point in time. Nonetheless, Participants and Access Persons do know that the Marketplace Thresholds should trigger before an SSCB and this fact must be taken into account in setting the order parameters in any automated order system when the Guidance on Marketplace Thresholds becomes effective.

IIROC has also issued additional guidance on best execution and management of orders and on the use of certain order types (particularly “Stop Loss Orders” that are entered as market orders when triggered).⁸

⁸ IIROC Notice 11-0113 – Rules Notice – Guidance Note – UMIR – *Guidance on Best Execution and Management of Orders* (March 30, 2011) and IIROC Notice 11-0114 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Use of Certain Order Types* (March 30, 2011). See also IIROC Notice 13-0191 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Management of Stop Loss Orders* (July 11, 2013).



2.3. Marketplace Controls and Obligations

2.3.1. Existing Marketplace Controls

Several marketplaces currently maintain volatility parameters under which orders entering the marketplace are monitored for the effect that the execution of the order would have on market prices. In the case of Alpha, TSX, TSXV, TMX Select and CSE (previously known as CNSX/Pure Trading), if an incoming order for a particular security would, on execution, result in a trade price that would differ from the last sale price on that marketplace for that security by more than an established amount (the “freeze parameter”), trading is “frozen” until the marketplace can determine if the incoming order is “valid”.⁹ If the marketplace is able to confirm the validity of the order (either by contacting the person who entered the order or by reviewing the market conditions), the freeze is lifted and the trade proceeds. If the trade is determined to be “invalid” (such as a “clearly erroneous” order), the order is removed and trading resumes. If trading is “frozen”, this is considered a “business halt” and trading in the particular security may continue on other marketplaces.

One shortcoming of freeze parameters is that they may not be triggered if the price movement is caused by the entry of more than one active order, even if the entry of the orders would otherwise be clearly erroneous, such as in the case of a runaway algorithm.

The freeze also inhibits additional order entry or change until the freeze is removed. In rapidly moving markets, the market price could move away during the period the freeze is in effect and dealers are not able to manage their orders. On the resumption of trading, orders in the book could be “taken advantage of” if the dealers are unable to change their orders to reflect the current market before other incoming orders trade against them. During the period of the freeze, the liquidity in the book of the marketplace invoking the freeze would be unavailable and order routers may bypass that marketplace and trade on other marketplaces albeit possibly at inferior prices to the liquidity available on the marketplace that imposed the freeze.

Alpha, TSX, TSXV, TMX Select and CSE also employ “bid/ask tick limits” under which market orders and limit orders that would execute outside of an established range are re-priced by the marketplace prior to being entered into the book. This “collar” prevents a single market order or an aggressively-priced limit order from trading outside the range which is based on a transparent matrix of different “collars” for securities priced at varying levels. For example, on the TSX and TSXV, a market sell order for a security trading between \$1.00 and \$5.00 would be assigned a maximum limit price of the existing bid at the time of the entry of the order less \$0.25.

⁹ TMX Select operates a similar system of volatility parameters, but the TMX Select parameters also take into account the last sale price of the security on the TSX or TSXV.



Chi-X and CX2 maintain similar programs governing market volatility but, rather than freezing trading, they reject the suspect incoming order and trading continues.¹⁰ The reject parameters on Chi-X and CX2 are determined by multiple price bands calculated as a percentage of value from the last sale price. The price bands vary depending on the price of the security, and any order which would exceed a price band is rejected. If an order is rejected, the order may be rerouted to another marketplace trading the particular security. The advantage of reject parameters is that trading continues and it is only the “offending” order that is returned to the dealer for handling. One possible shortcoming of the use of reject parameters comes if the rejected order is simply rerouted by a smart order router to the next best available marketplace – an outcome which may simply pass the problem of an erroneous order to another marketplace.

The remaining marketplaces in Canada do not currently maintain or enforce volatility parameters. Omega is a transparent marketplace which may execute clearly erroneous trades. Omega has policies to cancel such trades following execution but not to catch the orders on entry. Instinet, Liquidnet and MATCH Now are dark pools and the functionality of their respective marketplaces reduces or eliminates the need to monitor for clearly erroneous orders (for example, all executions on MATCH Now must occur between the “best bid” and “best ask” on the transparent marketplaces).

2.3.2. Obligations Under the Electronic Trading Rule

Section 8 of the Electronic Trading Rule provides that a “marketplace must not permit the execution of orders for exchange-traded securities to exceed the price and volume thresholds” set by the marketplace or, if the marketplace has retained a regulation services provider, its regulation services provider. Since all marketplaces trading listed securities and quoted securities in Canada have retained IIROC to be their regulation services provider, the thresholds would be established by IIROC.¹¹ Until IIROC issues the Guidance establishing marketplace price and/or size thresholds, each marketplace is able to continue the use of its existing mechanisms for controlling volatility and detecting clearly erroneous orders. A marketplace which does not currently have a mechanism to control volatility would not be required to adopt a mechanism prior to IIROC establishing price and/or size parameters.

¹⁰ Prior to the adoption on April 29, 2013 of “freeze parameters” with section 5.6 of the Trading Policies of Alpha, Alpha’s volatility controls were comparable to those used by Chi-X.

¹¹ If IIROC ceases to be the regulation services provider for any marketplace trading listed or quoted securities, subsection 8(2) of the *Electronic Trading Rule* would require IIROC to coordinate the thresholds with the other regulation services providers and any Exchanges or QTRSs that perform their own market integrity regulation.



2.4. Power for Regulatory Halts in Canada

Rule 9.1 of UMIR allows IIROC to impose a trading halt or suspension for regulatory purposes. Such a regulatory halt or suspension may apply to a particular security traded on a marketplace, to a range of securities or to trading of all securities generally. In accordance with Rule 9.1, no order for the purchase or sale of a listed security shall be executed on a marketplace or over-the-counter at any time while the regulatory halt applicable to that security remains in effect. If the regulatory halt has been imposed for reasons other than the issuance of a cease trade order by an applicable securities regulatory authority, a trade may be executed outside of Canada on a foreign organized regulated market if such a trade is permitted by applicable securities legislation.

2.4.1. Single-Stock Circuit Breakers

Effective February 2, 2012, IIROC issued guidance¹² indicating that the power to halt or suspend trading pursuant to Rule 9.1 would be exercised in the event of rapid and unexplained price movement in a particular security in certain circumstances. Under that guidance, SSCBs:

- apply to:
 - each security that is a constituent of the S&P/TSX Composite Index, and
 - each Exempt Exchange-traded Fund the assets of which is comprised principally of listed securities;¹³
- provide for a trigger level such that there would be a halt in the event of a price increase or decline of at least 10% in a 5-minute period;
- apply from 9:50 a.m. to 3:30 p.m.;
- provide an initial halt of 5 minutes that may be extended for a further 5-minute period;
- exclude from the trigger calculation prices of trades that may execute outside the “best bid – best ask” spread; and

¹² For details on the operation of Single-Stock Circuit Breakers, see IIROC Notice 12-0040 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Implementation of Single-Stock Circuit Breakers* (February 2, 2012).

¹³ In UMIR, an “Exempt Exchange-traded Fund” means a mutual fund for the purposes of applicable securities legislation, the units of which:

- (a) are a listed security or a quoted security; and
- (b) are in continuous distribution in accordance with applicable securities legislation

but does not include a mutual fund that has been designated by the Market Regulator to be excluded from the definition.

To date, no security has been designated to be excluded from the definition. IIROC would propose to publish on its website a list of those Exempt Exchange-traded Funds that are subject to being halted by the triggering of a Single-Stock Circuit Breaker.



- would result in the cancellation of any trade that executes at more than 5% beyond the trigger price.

IIROC has issued a separate request for comments on proposed changes to the operation of SSCBs.¹⁴ Among the changes which are being proposed for SSCBs are provisions for:

- an extension to cover securities which are “actively-traded”;¹⁵
- an extension of the operation of SSCBs to cover “regular trading hours” from 9:30 a.m. to 4:00 p.m.;¹⁶
- a minimum increment movement to trigger a SSCB of 20 trading increments after 9:50 a.m. and before 3:30 p.m.;
- a higher percentage price movement trigger threshold from 9:30 to 9:50 a.m. and from 3:30 p.m. to 4:00 p.m. of the greater of 20% and 40 trading increments; and
- the operation of SSCBs 30 minutes following the resumption of trading in a security after a regulatory halt.

For the listed securities not covered by SSCBs, their trading patterns and liquidity profiles are such that automated trading halts are neither practical nor appropriate. In the view of IIROC, trading anomalies for these securities are best dealt with pursuant to the Unreasonable Trade Policy described below.

2.4.2. Unreasonable Trade Policy

On August 20, 2012, IIROC issued guidance¹⁷ on the circumstances in which IIROC may undertake discretionary regulatory intervention under the authority of Rule 10.9 of UMIR to vary or cancel any trade that is, in the opinion of the Market Integrity Official:

- “unreasonable” as undertaken when material information related to the issuer of the security may be known to certain parties trading in the market but the information has

¹⁴ IIROC Notice 13-0298, *op. cit.*

¹⁵ For the purposes of the proposed extension of Single-Stock Circuit Breakers, “actively-traded security” would mean a listed security or quoted security that has traded, in total, on one or more marketplaces as reported on a consolidated market display during the three calendar months ending immediately preceding the determination:

- an average of at least 500 times per trading day or such greater number of times as designated from time to time by the Market Regulator for the purposes of this clause; and
- with an average trading value of at least \$1,200,000 per trading day or such greater value as designated from time to time by the Market Regulator for the purposes of this clause.

¹⁶ The proposed guidance confirms that the triggering of a Single-Stock Circuit Breaker late on a trading day will not affect the operation of any Market-on-Close facility or the eligibility of the particular security to trade on a marketplace pursuant to Closing Price Orders.

¹⁷ IIROC Notice 12-0258 - Rule Notice – Guidance Note – UMIR - *Guidance on Regulatory Intervention for the Variation or Cancellation of Trades* (August 20, 2012).



not been publicly disseminated in accordance with applicable timely disclosure standards (“asymmetric dissemination of material information”);

- “unreasonable” in connection with an unintentional “erroneous” trade; or
- not in compliance with the provisions of UMIR.

The guidance provided transparency and greater certainty respecting the criteria for discretionary regulatory intervention, which may be exercised in these circumstances outside the scope of operation of the SSCBs to ensure a “fair and orderly market” in the trading of a listed security.

Under the guidance, the discretion of a Market Integrity Official to vary or cancel a trade under Rule 10.9 of UMIR is subject to guidelines that include:

- a “no touch zone” for which there will generally be no regulatory intervention by IIROC when the price difference between an “erroneous” trade and the current fair value of the security does not exceed the greater of 10% of the price of the security or 10 trading increments;
- limited conditions under which regulatory intervention to cancel an “erroneous” trade would be considered, in particular circumstances of:
 - extreme price dislocation when there would be no reasonable expectation of execution, or
 - a trading error that does not impact market price but places the issuer at risk; and
- determination based on market conditions as to whether a higher threshold than the “no touch zone” will be used when an “erroneous” trade has been executed during a period of significant market volatility, outside normal trading hours or in a security of limited or very limited liquidity.

2.4.3. Market-wide Circuit Breakers

Since the introduction of UMIR in 2002, IIROC and its predecessor have issued guidance that the power to halt or suspend trading pursuant to Rule 9.1 would be exercised in order to coordinate market-wide halts with those in the United States. Effective April 8, 2013, the guidance issued by IIROC¹⁸ confirms that trading halts in Canada will continue to be coordinated with market-wide halts in the United States.¹⁹

¹⁸ IIROC Notice 13-0059 – Rules Notice – Guidance Note – UMIR – *Guidance Respecting Market-wide Circuit Breakers* (February 21, 2013).

¹⁹ Under the guidance, a market-wide circuit breaker will be triggered when the S&P 500 Index declines below its closing value on the previous trading day by:

Level 1 - 7%
Level 2 - 13%
Level 3 - 20%



2.5. Developments in the United States

As of June 11, 2010, markets in the United States participated in a single-stock circuit breaker pilot program that initially applied to securities included in the S&P 500 Index.²⁰ Following the implementation of the single-stock circuit breaker pilot project, there was a re-evaluation of the overall effectiveness of the program, particularly in light of the numerous instances of the circuit breakers triggering due to erroneous trades. On April 5, 2011, the major U.S. exchanges and the Financial Industry Regulatory Authority (“FINRA”) submitted a proposal to the Securities and Exchange Commission (“SEC”) in an attempt to address these shortcomings by establishing the Limit Up-Limit Down program (“LULD”) as market-wide controls in trades of securities covered by the National Market System (“NMS Stocks”) that would replace the existing single-stock circuit breaker program.²¹ This proposal, as amended, was approved for implementation on a pilot project basis. This first phase of the implementation became effective April 8, 2013 with “Tier 1 NMS Stocks”.²² The second phase of the implementation started on August 5, 2013 with the application of LULD extended to “Tier 2 NMS Stocks” based on a rollout schedule established by the listing markets.²³ During the first phase, LULD only applied from 9:45 a.m. to 3:35 p.m. and did not apply during the opening (from 9:30 a.m. to 9:45 a.m. Eastern Time) and closing (from 3:35 p.m. to 4:00 p.m.

The length of the regulatory halts at each level is as follows:

Level 1:

- before 3:25 p.m. – 15 minutes
- at or after 3:25 p.m. – trading shall continue, unless there is a Level 3 halt

Level 2:

- before 3:25 p.m. – 15 minutes
- at or after 3:25 p.m. – trading shall continue, unless there is a Level 3 halt

Level 3:

- at any time – trading shall halt and not resume for the remainder of the trading day.

In the event that marketplaces in Canada are open for trading on a trading day or a portion of a trading day that markets in the United States are not scheduled to be open for trading, trading halts will be triggered on those trading days or portions of trading days when the S&P/TSX Composite Index declines below its closing value on the previous trading day by the same percentage.

If there is a market-wide halt in trading as a result of a Level 3 market-wide circuit breaker, the general provision is that trading will not resume on marketplaces for the remainder of the trading day. The guidance sets out the criteria which IIROC will consider in determining whether to allow the execution of Closing Price Orders or the operation of a Market-on-Close facility following a Level 3 market-wide circuit breaker.

In all other respects, the timing and duration of the market-wide trading halt will be in accordance with the requirements established in the United States.

²⁰ On September 10, 2010, the SEC approved new rules submitted by the national securities exchanges and FINRA to expand a recently-adopted circuit breaker program to include all stocks in the Russell 1000 Index and certain exchange-traded funds. See, for example, SEC Release No. 34-62884, *Order Approving Proposed Rule Changes Relating to Expanding the Pilot Rule for Trading Pauses Due to Extraordinary Market Volatility to the Russell 1000® Index and Specified Exchange Traded Products*.

²¹ See File 4-631 – National Market System Plan to Address Extraordinary Market Volatility. The text of the plan is available at: <http://www.sec.gov/news/rules/sro/nms/2012/34-67091.pdf>.

²² “Tier 1 NMS Stocks” are securities in the S&P 500 Index or Russell 1000 Index and certain exchange-traded products (“ETPs”) which are not leveraged and with a consolidated average daily trading value of more than \$2 million. In addition, other ETPs which “track the same benchmark as an ETP that does meet the volume criterion, will be deemed eligible to be included as a Tier 1 NMS Stock”).

²³ “Tier 2 NMS Stocks” include all NMS Stocks other than those in Tier 1. For the application during second phase, see for example Equity Regulatory Alert #2013 – 9 of NASDAQ OMX available at <http://www.nasdaqtrader.com/TraderNews.aspx?id=ERA2013-9>.



Eastern Time).²⁴ Effective August 5, 2013, LULD does not apply to the final 15 minutes of trading (from 3:45 p.m. to 4:00 p.m. Eastern Time). The rollout to all Tier 2 NMS Stocks was completed on or before December 8, 2013”.²⁵ However, further amendments to the LULD plan were made to delay until on or before February 24, 2014 the extension of LULD to cover the last 15 minutes of trading.²⁶

LULD prevents trades in NMS Stocks from occurring outside specified price bands, which are set at a percentage level above and below the arithmetic mean of trades in a particular stock over the preceding 5-minute period.²⁷ These percentage parameters generally are doubled during the opening and closing and would be double for Tier 2 NMS Stocks as compared to Tier 1 NMS Stocks. However, for securities trading below \$0.75, the percentage parameters are, at all times, the lesser of \$0.15 or 75% and would apply to both Tier 1 NMS Stocks and Tier 2 NMS Stocks.

Class of Securities	Reference Price	Percentage Parameter	
		Opening and Close	9:45 a.m. – 3:35 p.m.
Tier 1 NMS Stocks	> \$3.00	10%	5%
	\$0.75 - \$3.00	40%	20%
	< \$0.75	Lesser of \$0.15 or 75%	Lesser of \$0.15 or 75%
Tier 2 NMS Stocks	> \$3.00	20%	10%
	\$0.75 - \$3.00	40%	20%
	< \$0.75	Lesser of \$0.15 or 75%	Lesser of \$0.15 and 75%

When one side of the market for a security is outside the price band, that quote is identified as non-executable. When the other side of the market reaches the price band, the market for that security enters a limit state. All trading in a security enters a limit state when the National Best Offer equals the lower limit band or the National Best Bid equals the upper limit band. Trading for a particular NMS Stock exits a limit state if the entire size of all limit state quotes is executed or cancelled within a 15-second time period. If the market does not exit the limit state within 15 seconds, the primary listing exchange declares a 5-minute halt. In the first phase of implementation (prior to the roll out of any Tier 2 NMS Stocks), a limit state was

²⁴ With the introduction of LULD, each of the marketplaces repealed their own mechanisms for the control of volatility. However, as a result of volatility in securities covered in Phase 1 of LULD during trading outside the period covered by LULD, the NYSE announced its intention to reintroduce its own controls (known as liquidity replenishment points) to apply during the open and close periods not covered during Phase 1 of LULD.

²⁵ Equity Regulatory Alert #2013-9.

²⁶ <http://www.sec.gov/rules/sro/nms/2014/34-71247.pdf>.

²⁷ The first reference price will be either the opening price or the bid/ask midpoint of the opening quote on the primary listing market. The price bands would be calculated by the Securities Information Processors (“SIPs”) responsible for the consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS. The SIPs would disseminate the price bands to markets, dealers, information vendors and service providers. The SIPs would also calculate a “Pro-Forma Reference Price” for each NMS Stock on a continuous basis during regular trade hours. If the Pro-Forma Reference Price did not move by one percent or more from the reference price in effect, no new price bands would be disseminated. Each new reference price would remain in effect for at least thirty seconds.



reached only 4 times and none resulted in a trading pause. In each case, the securities affected were less liquid ETPs.²⁸

Following the start of the second phase of implementation on August 8, 2013, NYSE Arca instituted on August 28, 2013 a “rollback” to temporarily remove 530 ETPs, or approximately 40% of the listed ETPs, from the LULD program as a result of the triggering of a number of trading halts affecting thinly-traded securities.²⁹ Effective September 26, 2013, the SEC approved further amendments to the LULD plan to exclude a group of illiquid ETPs from the LULD program after a series of halts were triggered affecting illiquid ETPs, often in the absence of any actual trades.³⁰ The amendment also changes the handling of a pause near the close of trading in that a pause during the last 10 minutes would result in trading not reopening on the “Primary Listing Exchange”. Despite the pause, the Primary Listing Exchange “shall attempt to execute a closing transaction using its established closing procedures”.³¹

The LULD pilot project required significant programming by market centres, service providers and dealers. The operation of LULD is also dependent on timely production and dissemination of price parameters and the ability of market centres and dealers to consume and respond to information on the price parameters with minimal latencies even in periods of significant market stress arising from unusual volumes or generalized price volatility.

3. Response to the Request for Comments

On May 10, 2012, IIROC Notice 12-0162 requested comments on Marketplace Thresholds (“Request”). IIROC received five comments in response to the Request.³² Appendix B to this Notice presents a summary of the comments received and IIROC’s responses.

Overall, there was no consensus among the commentators as to the appropriate approach that IIROC should adopt in connection with the establishment of Marketplace Thresholds. Nonetheless, after considering the comments, IIROC has drafted the Proposed Guidance to:

- be principles-based to the greatest extent possible;

²⁸ ETPs include exchange traded funds and exchange traded notes.

²⁹ http://www.nyse.com/pdfs/2013_08_26_LULD%20Phase%20%20partial%20rollback.pdf. The affected securities had an average daily trading volume of 10,000 shares or less in the 30-day period ending August 21, 2013. Upon removal from LULD, the securities returned to the pre-existing Volatility Trading Pause program. NYSE Arca indicated that it “will be working with LULD Plan Participants to assess whether there are further refinements to the LULD Plan that would more fully optimize processing of limit states and halts.”

³⁰ <http://www.sec.gov/rules/sro/nms/2013/34-70530.pdf>. In particular, the amendment excludes ETPs that did not meet the average daily trading value of more than \$2 million but tracked the same benchmark as an ETP that does meet the volume criterion.

³¹ For example, BATS Exchange has disclosed that “pending SEC filing and Approval” it intends to establish the closing price for a security in the following manner: “If a security is halted due to a LULD pause between 3:50 pm and 4:00 pm ET, a Volatility Closing Auction will be held at 4:00 pm. The will end the LULD pause and set the Closing Price for the security.”

See http://cdn.batstrading.com/resources/membership/BATS_US_Equities_Limit_Up_Limit_Down_FAQ.pdf.

³² A copy of the comment letters received in response to the Request is publicly available on the IIROC website at: <http://www.iroc.ca/SitePages/Comments-Received.aspx?linkid=867>.



- allow each marketplace flexibility in the structure and application of its Marketplace Thresholds based on the type of trading undertaken on the marketplace and the liquidity on that marketplace, including the ability to tailor the applicable thresholds to the trading patterns and liquidity of particular securities; and
- ensure that Marketplace Thresholds can be implemented with minimal impact on the systems of Participants, Access Persons, service providers or the information processor.

4. Summary of Proposed Guidance

4.1. Reason for Guidance

As discussed above, the initial responsibility for preventing “clearly erroneous” orders rests with Participants. The next line of defense would be the Marketplace Thresholds. Only in rare circumstances should it be necessary for the clearly erroneous order to be caught by the SSCB or by the application of the Unreasonable Trade Policy. IIROC believes that SSCBs and the Unreasonable Trade Policy should not be relied on for dealing with “clearly erroneous” trades, but should remain focused on addressing rapid and significant price movements due to sudden shifts in liquidity for a particular security that impact the continuance of a “fair and orderly” market.

IIROC’s preference is that market forces drive trading activity without interference provided there is a fair and orderly market. If material information has been properly disclosed to market participants, the price discovery mechanism should be allowed to work and the market price of the security may move rapidly to a new level, but such movement would be explained by the market’s evaluation of the material news or information.

The LULD approach not only catches “erroneous” orders but may restrict the ability of the price of a security to move to its proper level based on true supply and demand.³³

A number of commentators on the Request indicated a preference for Marketplace Thresholds to be “harmonized”. Marketplace Thresholds could be harmonized as to **functionality** (but with different possible results based on the same trading activity) or they could be harmonized to require each marketplace to have the **same result** (which would require the marketplaces to base their actions on a common data source).

While harmonized Marketplace Thresholds have the benefit of being easily understood by market participants and provide a degree of predictability, this objective should be balanced against the potential costs of harmonization, and the degree of flexibility that a marketplace requires in adopting parameters that are appropriate for the type of trading undertaken on its market. For example, for lower-priced securities and securities with limited liquidity, a “one

³³ The “limit up-limit down” mechanism was originally employed in the derivatives markets to ensure that the price of the derivatives did not “decouple” from the value of the underlying securities or indices on which the derivatives were based.



size fits all” approach to controlling price volatility may neither be appropriate nor practical. Just as IIROC is proposing that the SSCBs should not be extended to all securities, IIROC is proposing that each marketplace have flexibility in designing Marketplace Thresholds for the type of trading undertaken on its market. In these circumstances, each marketplace should be transparent as to the type of volatility parameters employed and the differences in the triggering of Marketplace Thresholds for each type of security.

4.2. Suggested Guiding Principles for Marketplace Thresholds

IIROC is proposing three guiding principles for marketplaces to evaluate whether a particular mechanism for controlling price movement by precluding execution of certain orders is effective and can be appropriately integrated into the multi-tiered approach for the control of short-term volatility.

4.2.1. Application Prior to Level of Volatility for Regulatory Intervention

In the ordinary course, Marketplace Thresholds should preclude the execution of an order that would otherwise trigger regulatory intervention in the form of a SSCB or trade variation or cancellation under the Unreasonable Trade Policy. The price movement need not be intentional on the part of the person(s) entering the order(s) but rather may be the result of a malfunctioning algorithm, input errors or the cascading effects of stop-loss orders, among other things.

Currently, many of the mechanisms employed by marketplaces determine whether a single active order received by the marketplace would interact with the passive orders in the book to the extent that resulting trade prices would move the market more than an acceptable amount. This type of mechanism would not catch a series of orders, often generated by an automated order system or resulting from the triggering of stop-loss orders held for processing by the marketplace, which have the combined effect of moving the market more than an acceptable amount in a minimal period of time.

At a minimum, Marketplace Thresholds should be designed to preclude the execution of an order that would move the market more than an acceptable amount where that order is:

- a single active order received by the marketplace;
- part of a series of orders for a particular security, the preponderance of which have been generated from the same source (e.g. the same “Trader ID”) over a very short period of time (e.g. one minute or less); or
- one of a series of stop-loss orders for a particular security that are held by the marketplace for processing which have been triggered at the same time or in succession over a very short period of time (e.g. a few seconds or less).



IIROC recognizes that each marketplace will be well aware of when a SSCB would be triggered. On the other hand, the Unreasonable Trade Policy clearly sets out the circumstances when IIROC would **not intervene** but only identifies the factors that would be taken into account when IIROC exercises its discretion to intervene. While SSCBs may be expanded to cover securities which account for approximately 90% of the value traded and number of trades, those securities account for less than 10% of listed issues. The liquidity profile of the remaining 90% of securities is such that the measurement of price movement over a short period of time is extremely problematic. For this reason, IIROC recognizes that any Marketplace Thresholds that may apply to these securities may be triggered based on price movement from the last sale price or the closing price on the prior trading day. For these securities, any Marketplace Threshold might trigger at a price level that is in excess of the movement that would trigger a SSCB. IIROC is specifically seeking comment on the guidance that should be provided to marketplaces for designing Marketplace Thresholds for securities not covered by a SSCB. (See Section 6 – Specific Questions.)

4.2.2. Minimum Impact on Price Discovery and Access to “Tradable” Liquidity

The control mechanism used by a marketplace should have the least amount of impact that is practical on the market-wide operation of the price discovery mechanism and access to “tradable” liquidity.

IIROC believes that the application of Marketplace Thresholds should not exacerbate price movement during periods of rapid market volatility by:

- preventing access to orders that would otherwise be able to execute at “acceptable” prices; or
- redirecting “unacceptable” orders to other marketplaces or returning the orders to a smart order router for re-entry on another marketplace.

In the Request, IIROC sought comment on whether it was appropriate to require marketplaces that were using “freeze” parameters to allow for order entry and cancellation during the period of the freeze and whether it would be appropriate to limit the period that the freeze could be in effect. IIROC also sought comment on whether a marketplace that used “reject” functionality should be required to carry a message as to the reason for the rejection so that the order would not be automatically re-routed to another marketplace without intervention from the Participant or Access Person who entered the order. Certain of the comments received in response to these questions indicated that IIROC should avoid being prescriptive and allow marketplaces flexibility in complying with the principle. In addition, one commentator noted that IIROC’s suggestion on the handling of rejected orders would involve additional programming on behalf of other marketplaces, service providers and Participants.



As an administrative matter, IIROC has treated the initial trade following the release of “freeze” parameters to be akin to an “Opening Order” and therefore not subject to compliance with the Order Protection Rule under Part 6 of National Instrument 23-101. IIROC would propose to modify its administrative interpretation such that if the functionality of the Marketplace Thresholds:

- permits order entry, variation and cancellation during the period when execution is precluded, the initial execution following the resumption of trading would continue to be treated as akin to execution of an Opening Order; or
- does not permit order entry, variation and cancellation during the period when execution is precluded, the initial execution following the resumption of trading could not be at a price which is less than the best bid price or higher than the best ask price at the time of the execution.

With these modifications, the Proposed Guidance would provide marketplaces with flexibility in determining the functionality of their Marketplace Thresholds while ensuring that existing orders on marketplaces cannot be “taken advantage of”. The changes also alleviate the need to address the duration of the freeze and leave that matter to the discretion of the marketplace. By taking steps to reduce the risk exposure of Participants and Access Persons arising from “frozen” and “rejected” orders, the need for predictability of the triggering points of Marketplace Thresholds is also reduced.

4.2.3. Minimum Imposition of Regulatory Burden on Other Entities

IIROC is suggesting the addition of a third principle for Marketplace Thresholds that the functionality adopted by a marketplace should, to the greatest extent possible, not impose a regulatory burden (including the need for technological changes) on other marketplaces, service providers, regulation services providers, information processors, Participants and Access Persons.

If the functionality of the Marketplace Thresholds simply “rejects” offending orders, that mechanism would not meet the second principle outlined above. Amending the functionality to provide a message as to the reason for the rejection would require systems changes by various market participants. In the view of IIROC, the execution of offending orders could equally be precluded under Marketplace Thresholds that execute the order to the limit provided by the Marketplace Threshold with the balance of the order “re-priced” and booked as a limit order at that price or cancelled. Use of these options may not require any programming changes by other market participants. Upon receiving notice that a portion of the order had been re-priced or cancelled, the Participant or Access Person that entered the order may not simply “regenerate” the balance of the order but must review the order to



ensure that re-entry would not interfere with a “fair and orderly” market in a manner that may give rise to regulatory intervention by IIROC to vary or cancel any resulting trades.³⁴

Notwithstanding this third principle, IIROC expects that the regulatory feed containing order and trade information which is provided to IIROC by each marketplace will indicate an order which has triggered the Marketplace Threshold and each order which has been precluded from execution (including by reason of being frozen, re-priced or cancelled). By monitoring this information on the regulatory feed, IIROC may determine whether multiple marketplaces are experiencing at the same time a problem with a particular security. This may be indicative that trading is no longer fair and orderly such as when trading activity may be occurring on the basis of material information that has not been properly disclosed to the market. In these types of circumstances, IIROC may exercise its discretionary power to impose a regulatory trading halt pursuant to Rule 9.1 of UMIR.

4.3. Specific Guidance Elements

4.3.1. No Requirement for Volume Controls

In the United States, there has been considerable discussion about the merits of markets having “kill switches” to stop further order entry from a dealer if the volume associated with the orders entered by a particular dealer exceeds pre-set limits.³⁵ IIROC believes that “kill switches” at the marketplace level could have the effect of precluding entry on a marketplace of legitimate orders from a specific dealer that is merely responding to shifts in market liquidity for a particular security between the various marketplaces, or executing a temporary increase in client activity, for example.

Effective March 1, 2013, Part 7 of Policy 7.1 of UMIR requires that a Participant or Access Person have automated controls to examine each order before entry on a marketplace to prevent the entry of an order that would result in, among other things, the Participant, Access Person or Participant’s client exceeding pre-determined limits on the value or volume of unexecuted orders for a particular security or class of securities. That Policy also requires that each Participant or Access Person have automated controls to prevent the entry of an order that would result in the Participant or Access Person exceeding pre-determined credit or

³⁴ See Part 7 of Policy 7.1. See in this Notice section 2.2 *Obligations of Participants and Access Persons* and section 2.4 *Power for Regulatory Halts in Canada*.

³⁵ In large part, this suggestion has been a response to the problems experienced by Knight Capital in August of 2012 when, in response to a change introduced by NYSE, the systems of Knight incorrectly generated and entered orders on the NYSE in a range of securities that resulted in significant trading losses for the firm. On December 20, 2013, the NYSE filed with the SEC a proposal to offer optional risk management tools designed to allow member organizations to monitor and address exposure that would facilitate, among other things, blocking of a member organization’s orders if certain thresholds were met. See <http://www.sec.gov/rules/sro/nyse/2013/34-71164.pdf>.



capital thresholds.³⁶ Given that these controls apply to the overall position of the Participant or Access Person, they are effectively “kill switches”.

For these reasons, IIROC does not believe at this time that a volume control or “kill switch” by itself needs to be included in any Marketplace Threshold regime. Nonetheless, a marketplace would be able to include a volume control in its Marketplace Thresholds if the marketplace so determined.³⁷

4.3.2. Application Limited to a “Protected Marketplace”

IIROC believes that only a “protected marketplace” must adopt Marketplace Thresholds.³⁸ All of the current marketplaces other than MATCH Now, Liquidnet and Instinet qualify as a “protected marketplace”. These three marketplaces are “dark pools” and may only execute a trade at a “better price” than the best bid price and the best ask price.³⁹ Given the limitations on the price at which a Dark Order may execute, IIROC believes that there would be no benefit in extending the requirement for Marketplace Thresholds to dark pools. Since SSCBs were introduced in February of 2012, no SSCB has been triggered as a result of an execution of a trade on a dark pool. Nonetheless, if a dark pool adopts a volatility control mechanism, IIROC would expect that the mechanism would comply with the Proposed Guidance.

4.3.3. Application to Orders that Could Establish “Last Sale Price”

Marketplace Thresholds should be designed to apply to any order received by the marketplace that on execution would establish the “last sale price”.⁴⁰ In particular, this means that an order entered as an Opening Order or Market-on-Close Order would be subject to some form of volatility control. IIROC recognizes that the mechanism that a marketplace may apply to Opening Orders or Market-on-Close Orders may not apply to individual orders but rather to the movement in the execution price of all Opening Orders or Market-on-Close Orders from an appropriate reference price.

³⁶ See “Obligations of Participants and Access Person” on page 5 to 7.

³⁷ In effect this is comparable to what NYSE is proposing in that the risk controls contemplated by NYSE are “optional”.

³⁸ Reference should be made to Rule 1.1 of UMIR for the definitions of “protected marketplace”, “better price” and “Dark Order”. If a protected marketplace offers a separate facility that operates as a “dark pool”, orders entered on the separate “dark pool” need not be subject to Marketplace Thresholds provided orders entered on the dark pool that do not execute are not forwarded to any transparent facility of the marketplace.

³⁹ One exception to this requirement for price improvement is when an order that has been entered as a “Dark Order” and the incoming order against which it will trade is for more than 50 standard trading units or has a value of more than \$100,000 (in which case the order may trade at either the best bid price or the best ask price).

⁴⁰ Reference should be made to Rule 1.1 of UMIR for the definitions of “last sale price”, “Opening Order” and “Market-on-Close Order”.



4.3.4. *No Impact on Market-on-Close Orders or Closing Price Orders*

Notwithstanding the proposed extension of SSCBs to cover trading from 9:30 a.m. to 4:00 p.m., the proposed guidance on SSCBs confirms that the triggering of a SSCB late on a trading day should not preclude the operation of any Market-on-Close (“MOC”) facility or the eligibility of the particular security to trade on a marketplace pursuant to Closing Price Orders. Similarly, Marketplace Thresholds should be designed in such a manner that their application late on a trading day would not preclude or otherwise affect the operation of any MOC facility or the eligibility of the particular security to trade on a marketplace pursuant to Closing Price Orders.

4.3.5. *Application of Marketplace Thresholds to “Directed-Action Orders”*

Marketplace Thresholds should be designed to apply to an order received by a marketplace that is a “directed-action order” (“DAO”).⁴¹ While a DAO is often considered an instruction to the receiving marketplace to immediately execute the order without reference to the prices of orders on other marketplaces, it is possible, that as a result of the application of Marketplace Thresholds, executions will be prevented that would otherwise be required in order to move the market price to a level that would be necessary to facilitate execution on another marketplace without “trading through”.⁴²

The role of Marketplace Thresholds is to preclude the execution of trades that would otherwise require regulatory intervention. IIROC is therefore concerned that a “voluntary opt out” (which would have the effect of excluding DAO from the application of Marketplace Thresholds) would merely lead to more interventions by IIROC than would otherwise be required.

4.3.6. *Transparency of Marketplace Threshold Functionality*

IIROC expects that each marketplace that has to adopt Marketplace Thresholds will publicly disclose, at least on the website of the marketplace, an outline of the functionality of its Marketplace Thresholds. Transparency of Marketplace Threshold functionality is necessary in order to allow a Participant or Access Person to comply with its obligations under UMIR and the Electronic Trading Rule.⁴³

⁴¹ See National Instrument 23-101 *Trading Rules* for the definition of a “directed-action order”.

⁴² If the Marketplace Threshold precludes the execution of a directed-action order, the Participant or Access Person that entered the order will have an obligation to re-enter the balance of the order or otherwise authorize its execution in order to comply with the requirements of the Order Protection Rule under Part 6 of National Instrument 23-101 *Trading Rules*.

⁴³ In particular, reference should be made to Part 8 of Policy 7.1 which deals with specific provisions applicable to automated order systems and which provides in part:



IIROC recognizes that marketplaces may design their Marketplace Thresholds to be “dynamic” and to vary for each individual security based on the historic trading patterns and liquidity for the security, or to take into account general market conditions such as increases in overall market volatility on particular trading days. As such, IIROC does not expect that disclosure will necessarily allow Participants and Access Persons to determine with accuracy when the Marketplace Thresholds would be reached for individual securities on a particular trading day.

Nonetheless, the disclosure of the functionality should identify whether:

- the functionality applies to all listed securities traded on that marketplace (and, if not, the differences in functionality for each class or group of securities);
- the same parameter that will trigger a Marketplace Threshold applies to all listed securities traded on that marketplace (and, if not, the description of each class or group of securities with a separate parameter);
- there are differences in the parameters at different times during the trading day or for different types of orders; and
- the marketplace retains discretion to vary the parameters during a trading day (and, if so, a description of the types of circumstances that would lead to the exercise of the discretion).

A marketplace should provide specific examples of how an order that triggers a Marketplace Threshold will be handled by that marketplace.

5. Technological Implications and Implementation Plan

5.1. Technological Implications

IIROC has endeavoured to structure the Proposed Guidance on Marketplace Thresholds such that its implementation would have minimal technological implications for Participants, Access Persons, the information processor, service providers and IIROC. Furthermore, a marketplace that is not a “protected marketplace” would not be required to adopt Marketplace Thresholds.

If the Proposed Guidance is adopted, protected marketplaces:

- using “freeze parameters” would, at a minimum, have to ensure that their functionality:
 - takes account of a series of orders from the same source, and

The scope of appropriate order and trade parameters, policies and procedures should be tailored to the strategy or strategies being pursued by an automated order system with due consideration to the potential market impact of defining such parameters too broadly and in any event must be set so as not to exceed the marketplace thresholds applicable to the marketplace on which the order is entered or would otherwise exceed the limits publicly disclosed by the Market Regulator for the exercise of the power of a Market Integrity Official under Rule 10.9 of UMIR.



- either permits order entry and cancellation during the period of the freeze or otherwise ensures that the initial trade following the lifting of the freeze is at or within the best bid price and the best ask price at that time;
- using “reject” functionality would, at a minimum, have to modify their functionality to either re-price the balance of any order to the threshold price or cancel the balance of any order that has not traded prior to hitting the threshold price; and
- without functionality would have to adopt a form of Marketplace Thresholds.

In all cases, each marketplace would have to modify existing functionality or introduce Marketplace Thresholds that, for the securities covered by the SSCB program, take into account the rate of price changes and do not simply rely on changes from the last sale price on that marketplace.

The Proposed Guidance does not require marketplaces to coordinate Marketplace Thresholds and each marketplace’s Marketplace Thresholds may operate independently of the Marketplace Thresholds of any other marketplace. Each marketplace is therefore able to tailor its Marketplace Thresholds to the type of trading and liquidity on that marketplace. The common thread is simply that the Marketplace Thresholds should in the ordinary course preclude the execution of an order that may otherwise result in regulatory intervention.

5.2. Implementation Plan

After considering the comments received in response to this Request for Comments, IIROC will issue final guidance. IIROC would expect that the guidance would be effective on a date set out in the Rules Notice that is **at least** 180 days following the publication of the notice. Protected marketplaces would be expected to have implemented Marketplace Thresholds consistent with the guidance by the effective date.

Following the issuance of the guidance, IIROC expects to meet with each of the marketplaces to discuss any changes the marketplace intends to make, or may be required to make, to its systems in order to comply with the guidance, including the level of disclosure that marketplace intends to make on its website regarding its Marketplace Thresholds.

6. Specific Questions

While comment is requested on all aspects of controlling short-term price volatility in the Canadian marketplace, IIROC specifically requests comment on the following questions:

1. IIROC is proposing that the implementation date be at least 180 days following the publication of the final Guidance. Is this time period adequate or too long? Are there any specific considerations which IIROC should take into account in establishing an implementation deadline?



2. The Proposed Guidance would require marketplaces to take account of a series of stop-loss orders for a particular security that are held by the marketplace for processing which have been triggered at the same time or in succession over a very short period of time. Are there any other types of orders that marketplaces should be specifically required to take into account in the design of their Marketplace Thresholds?
3. Given the infrequency of trades in many of the securities not covered by a SSCB is such that the measurement of price movement over a short period of time is extremely problematic, IIROC has suggested that any Marketplace Threshold for these securities may be measured on price movement from the last sale price or the closing price on the prior trading day. IIROC has also suggested that any Marketplace Threshold for these securities might trigger at a price level which is in excess of the percentages and increment movement that would trigger a SSCB. Should IIROC allow marketplaces to have discretion to design their Marketplace Thresholds for these securities or should IIROC establish a lower limit at which the Marketplace Threshold should be triggered? If a limit is to be established, what percentage price movement or increment movement would be appropriate?
4. The Proposed Guidance would require each marketplace to publicly disclose an outline of the functionality of its Marketplace Thresholds. Are there any additional specific items that a marketplace should address in the public disclosure?
5. The Proposed Guidance would not require a marketplace which is a “dark pool” to adopt Marketplace Thresholds based on the limitations currently in place on the execution of Dark Orders. (See section 4.3.2 *Application Limited to a “Protected Marketplace”*). Are there any circumstances that would justify the extension of the requirements for Marketplace Thresholds to non-protected marketplaces?
6. IIROC has endeavoured to structure the Proposed Guidance on Marketplace Thresholds such that its implementation would have minimal technological implications for Participants, Access Persons, the information processor, service providers and IIROC. Has IIROC achieved this objective? If not, what suggestions might we consider to better achieve the desired result?
7. The Proposed Guidance would allow each marketplace to establish its own Marketplace Thresholds which are most appropriate to the type of trading undertaken on that marketplace; the alternative would be some degree of harmonization. One of the perceived benefits of harmonization would be greater predictability. However, given that the Proposed Guidance includes measures to reduce the risk exposure of Participants and Access Persons arising from “frozen” and “rejected” orders (see section 4.2.2), would this benefit justify the potential costs of harmonization (which could require marketplaces, Participants and Access Persons to modify their systems to base their actions on a common data source)? Are there other benefits to harmonization?



8. The Proposed Guidance would not require marketplaces to include volume controls in their Marketplace Thresholds, given the existence of controls which each Participant or Access Person must have in place to monitor not only the credit position of clients but the capital position of the Participant or Access Person. Would there be any reason to require volume controls on orders at the marketplace level if the orders are not having an impact on market prices?

Appendix A – Text of Proposed Guidance



IIROC NOTICE

Rules Notice Guidance Note

UMIR

Please distribute internally to:
Legal and Compliance
Trading

Contact:

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14-00**
**** , 2014**

Guidance on Marketplace Thresholds

Executive Summary

This Guidance, which is effective on **, 2014, sets out a framework for the establishment and operation of price thresholds by each marketplace in Canada (“Marketplace Thresholds”). The Guidance is based on three principles:

- Marketplace Thresholds should operate to generally preclude the execution of orders at prices that would otherwise, on execution, require regulatory intervention by IIROC on the triggering of a Single-Stock Circuit Breaker (“SSCB”)⁴⁴ or the application of IIROC’s policies and procedures for the variation and cancellation of trades (“Unreasonable Trade Policy”).⁴⁵

⁴⁴ For details on the current operation of Single-Stock Circuit Breakers, see IIROC Notice 14-0*** – Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Extension of Single-Stock Circuit Breakers* (**, 2014).

⁴⁵ IIROC Notice 12-0258 - Rule Notice – Guidance Note – UMIR - *Guidance on Regulatory Intervention for the Variation or Cancellation of Trades* (August 20, 2012).



- The volatility control mechanism used by a marketplace should have the least amount of impact that is practical on the market-wide operation of the price discovery mechanism and access to “tradable” liquidity.
- The introduction or amendment of Marketplace Thresholds by a marketplace should, to the greatest extent possible, not impose a regulatory burden (including the need for technological changes) on other marketplaces or on service providers, regulation services providers, information processors, Participants and Access Persons.

In addition, the Guidance confirms that Marketplace Thresholds:

- need not include controls on the volume of a trade that would not unduly impact the market price;
- would only be required on “protected marketplaces”;
- should apply to all orders that, on execution, would be able to set the “last sale price”;
- regardless of the functionality used, should not preclude the operation of a Market-on-Close (“MOC”) facility or the eligibility of the particular security to trade on the marketplace pursuant to a Closing Price Order;
- should apply to an order received by a marketplace as a “directed-action order” (“DOA”); and
- should be publicly disclosed (at least on the website of the marketplace as to the functionality of the Marketplace Thresholds).

The Guidance establishes a framework under which each marketplace is able to adopt Marketplace Thresholds that are appropriate for the type of trading on that marketplace. As such, the Guidance does not prescribe levels of price movement at which the Marketplace Thresholds must preclude trading activity other than the requirement that they operate to generally preclude the execution of orders at prices that would otherwise trigger regulatory intervention by IIROC.



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1. Provision for Marketplace Thresholds

Section 8 of National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces* (“Electronic Trading Rule”) provides that a “marketplace must not permit the execution of orders for exchange-traded securities to exceed the price and volume thresholds” set by the marketplace or, if the marketplace has retained a regulation services provider, its regulation services provider. Since all marketplaces trading listed securities and quoted securities in Canada have retained IIROC to be their regulation services provider, the thresholds would be established by IIROC.⁴⁶

The Guidance establishes a framework under which each marketplace is able to adopt Marketplace Thresholds that are appropriate for the type of trading on that marketplace. As such, the Guidance does not prescribe levels of price movement at which the Marketplace Thresholds must preclude trading activity other than the requirement that they operate to generally preclude the execution of orders at prices that would otherwise trigger regulatory intervention by IIROC.

⁴⁶ If IIROC ceases to be the regulation services provider for any marketplace trading listed or quoted securities, subsection 8(2) of the *Electronic Trading Rule* would require IIROC to coordinate the thresholds with the other regulation services providers and any Exchanges or QTRSs that perform their own market integrity regulation.



2. Principles Guiding Marketplace Thresholds

IIROC has established three guiding principles for marketplaces to evaluate whether a particular mechanism for controlling price movement is effective and can be appropriately integrated into a multi-tiered approach for the control of short-term volatility.⁴⁷

2.1. Application Prior to Level of Volatility for Regulatory Intervention

In the ordinary course, Marketplace Thresholds should preclude the execution of an order that would otherwise trigger regulatory intervention in the form of a SSCB or trade variation or cancellation under the Unreasonable Trade Policy. IIROC recognizes that each marketplace will be well aware of when a SSCB would be triggered for a security. On the other hand, the Unreasonable Trade Policy clearly sets out the circumstances when IIROC would **not intervene** but only identifies the factors that would be taken into account when IIROC would exercise its discretion to intervene for the cancellation or variation of trades. The liquidity profile of many of the securities that are not covered by SSCBs is such that the measurement of price movement over a short period of time is extremely problematic. For this reason, IIROC recognizes that any Marketplace Thresholds that may apply to these securities may be triggered based on price movement from the last sale price or the closing price on the prior trading day. For these securities, any Marketplace Threshold might trigger at a price level which is in excess of the movement that would trigger a SSCB.

At a minimum, Marketplace Thresholds should be designed to preclude the execution of an order that would move the market more than an acceptable amount and that order is:

- a single active order received by the marketplace;
- part of a series of orders for a particular security, the preponderance of which have been generated from the same source (e.g. the same “Trader ID”) over a very short period of time (e.g. one minute or less); or
- one of a series of stop-loss orders for a particular security that are held by the marketplace for processing which have been triggered at the same time or in succession over a very short period of time (e.g. a few seconds or less).

⁴⁷ See Section 2.1 – *Controlling Unexplained Price Volatility* in IIROC Notice 13-0*** - Rules Notice Request for Comments – UMIR – *Proposed Guidance on Marketplace Thresholds* (**, 2013)



2.2. Minimum Impact on Price Discovery and Access to “Tradable” Liquidity

The control mechanism used by a marketplace should have the least amount of impact that is practical on the market-wide operation of the price discovery mechanism and access to “tradable” liquidity.

The application of Marketplace Thresholds should not exacerbate price movement during periods of rapid market volatility by:

- preventing access to orders that would otherwise be able to execute at “acceptable” prices; or
- redirecting “unacceptable” orders to other marketplaces or returning the orders to a smart order router for re-entry on another marketplace.

As an administrative matter, IIROC has treated the initial trade following the release of “freeze” parameters to be akin to an “Opening Order” and therefore not subject to compliance with the Order Protection Rule under Part 6 of National Instrument 23-101 (“Order Protection Rule”). IIROC has modified its administrative interpretation such that if the functionality of the Marketplace Thresholds:

- permits order entry, variation and cancellation during the period when execution is precluded, the initial execution following the resumption of trading would continue to be treated as akin to execution of an Opening Order; or
- does not permit order entry, variation and cancellation during the period when execution is precluded, the initial execution following the resumption of trading could not be at a price which is less than the best bid price or higher than the best ask price at the time of the execution.

2.3. Minimum Imposition of Regulatory Burden on Other Entities

Under the third principle for Marketplace Thresholds, the functionality adopted by a marketplace should, to the greatest extent possible, not impose a regulatory burden (including the need for technological changes) on other marketplaces or on service providers, regulation services providers, information processors, Participants and Access Persons.

If the functionality of the Marketplace Thresholds simply rejects offending orders, that mechanism would not meet the second principle outlined above. Amending the functionality to provide a message as to the reason for the rejection would require systems changes by various market participants. In the view of IIROC, the execution of offending orders could equally be precluded under Marketplace Thresholds that execute the order to the limit provided by the Marketplace Threshold with the balance of the order either “re-priced” and booked as a limit order at that price or cancelled.



Use of these options would not require any programming changes by other market participants. Upon the Participant or Access Person that entered the order receiving notice that a portion of the order had been re-priced or cancelled, UMIR requires that the Participant or Access Person not simply “regenerate” the balance of the order but review the order to ensure that its re-entry would not interfere with a “fair and orderly” market in a manner that may give rise to regulatory intervention by IIROC to vary or cancel any resulting trades.⁴⁸

Notwithstanding this third principle, IIROC expects that the regulatory feed containing order and trade information which is provided to IIROC by each marketplace will indicate an order which has triggered the Marketplace Threshold and each order which has been precluded from execution (including by reason of being frozen, re-priced or cancelled). By monitoring this information on the regulatory feed, IIROC may determine whether multiple marketplaces are experiencing at the same time a problem with a particular security. This may be indicative that trading is no longer fair and orderly such as when trading activity may be occurring on the basis of material information that has not been properly disclosed to the market. In these types of circumstances, IIROC may exercise its discretionary power to impose a regulatory trading halt pursuant to Rule 9.1 of UMIR.

3. Guidance on Specific Elements of Marketplace Thresholds

3.1. No Requirement for Volume Controls

IIROC is of the opinion that an order, the execution of which will not significantly impact the market price, should not necessarily be restricted under Marketplace Thresholds from execution because of the volume of the order. Effective March 1, 2013, Part 7 of Policy 7.1 of UMIR requires that a Participant or Access Person have automated controls to examine each order before entry on a marketplace to prevent the entry of an order that would result in:

- the Participant or Access Person exceeding pre-determined credit or capital thresholds;
- a client of the Participant exceeding pre-determined credit or other limits assigned by the Participant to that client; or
- the Participant, Access Person or client of the Participant exceeding pre-determined limits on the value or volume of unexecuted orders for a particular security or class of securities.

Because of the specific obligations imposed on Participants and Access Persons to have automated controls prior to order entry and the inability of a marketplace to accurately

⁴⁸ See Part 7 of Policy 7.1. See in this Notice section 2.2 *Obligations of Participants and Access Persons* and section 2.4 *Power for Regulatory Halts in Canada*.



determine what volume would be “appropriate” for a particular Participant or Access Person, IIROC does not believe at this time that a “volume” control by itself should be included in any Marketplace Threshold regime adopted by a marketplace. Nonetheless, a marketplace may include a volume control in its Marketplace Thresholds if the marketplace so determines.

3.2. Application Limited to a “Protected Marketplace”

IIROC believes that only a “protected marketplace”⁴⁹ must have adopted Marketplace Thresholds.⁵⁰

Given that orders must generally execute on a non-protected marketplace at a “better price” than the best ask price and best bid price, IIROC is of the view that there are limited opportunities for a trade to be executed on a non-protected marketplace at an unacceptable price level. Nonetheless, if a “non-protected” marketplace adopts a volatility control mechanism, that mechanism should comply with this Guidance.

3.3. Application to Orders that Could Establish “Last Sale Price”

Marketplace Thresholds should be designed to apply to any order received by the marketplace that on execution would establish the “last sale price”⁵¹ In particular, this means that an order entered as an Opening Order or a Market-on-Close Order would be subject to some form of volatility control. IIROC recognizes that the mechanism which a marketplace may apply to Opening Orders or Market-on-Close Orders may not apply to individual orders but rather to the movement in the execution price of all Opening Orders or Market-on-Close Orders from an appropriate reference price.

⁴⁹ UMIR defines a “protected marketplace” as a marketplace that:

- disseminates order data in real-time and electronically to the information processor or one or more information vendors in accordance with the Marketplace Operation Instrument;
- permits dealers to have access to trading in the capacity as agent;
- provides fully-automated electronic order entry; and
- provides fully-automated order matching and trade execution.

⁵⁰ Similarly, if a protected marketplace offers a separate facility that operates as a “dark pool”, orders entered on the separate “dark pool” need not be subject to Marketplace Thresholds provided orders entered on the dark pool that do not execute are not forwarded to any transparent facility of the marketplace.

⁵¹ UMIR defines “last sale price” as the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display but does not include the price of a sale resulting from an order that is:

- (a) a Basis Order;
- (b) a Call Market Order;
- (c) a Closing Price Order;
- (d) a Special Terms Order unless the Special Terms Order has executed with an order or orders other than a Special Terms Order; or
- (e) a Volume-Weighted Average Price Order.



3.4. No Impact on Market-on-Close Orders or Closing Price Orders

Marketplace Thresholds should be designed in such a manner that the application of the Marketplace Thresholds do not preclude or otherwise affect the operation of any MOC facility or the eligibility of the particular security to trade on a marketplace pursuant to Closing Price Orders.

3.5. Application of Marketplace Thresholds to “Directed-Action Orders”

Marketplace Thresholds should be designed to apply to an order received by a marketplace that is a DAO.⁵² While a DAO is often considered an instruction to the receiving marketplace to immediately execute the order without reference to the prices of orders on other marketplaces, it is possible that as a result of the application of Marketplace Thresholds, executions will be prevented that would otherwise be required in order to move the market price to a level that would be necessary to facilitate execution on another marketplace without “trading through”. If the Marketplace Threshold precludes the execution of a DAO, the Participant or Access Person that entered the order will have an obligation to re-enter the balance of the order or otherwise authorize its execution in order to comply with the requirements of the Order Protection Rule.

3.6. Transparency of Marketplace Threshold Functionality

IIROC expects that each marketplace that adopts Marketplace Thresholds will publicly disclose, at least on the website of the marketplace, an outline of the functionality of its Marketplace Thresholds. Transparency of Marketplace Threshold functionality is necessary in order to allow a Participant or Access Person to comply with its obligations under UMIR and the Electronic Trading Rule.⁵³

⁵² Under National Instrument 23-103 *Trading Rules*, a “directed-action order” means a limit order for the purchase or sale of an exchange-traded security, other than an option, that,

- (a) when entered on or routed to a marketplace is to be immediately
 - (i) executed against a protect order with any remained to be booked or cancelled; or
 - (ii) placed in an order book;
- (b) is marked as a directed-action order; and
- (c) is entered or routed at the same time as one or more additional limit orders that are entered on or routed to one or more marketplaces, as necessary, to execute against any protected order with a better price than the order referred to in paragraph (a).

⁵³ In particular, reference should be made to Part 8 of Policy 7.1 which deals with specific provisions applicable to automated order systems and which provides in part:

The scope of appropriate order and trade parameters, policies and procedures should be tailored to the strategy or strategies being pursued by an automated order system with due consideration to the potential market impact of defining such parameters too broadly and in any event must be set so as not to exceed the marketplace thresholds applicable to the marketplace on which the



IIROC recognizes that marketplaces may design their Marketplace Thresholds to be “dynamic” and to vary for each individual security based on the historic trading patterns and liquidity for the security, or to take into account general market conditions such as increases in overall market volatility on particular trading days. As such, IIROC does not expect that disclosure will necessarily allow Participants and Access Persons to determine with accuracy when the Marketplace Thresholds would be reached for an individual security at a particular point in time on a particular trading day.

Nonetheless, the disclosure of the functionality should identify whether:

- the functionality applies to all listed securities traded on that marketplace (and, if not, the differences in functionality for each class or group of securities);
- the same parameter that will trigger a Marketplace Threshold applies to all listed securities traded on that marketplace (and, if not, the description of each class or group of securities with a separate parameter);
- there are differences in the parameters at different times during the trading day or for different types of orders; and
- the marketplace retains discretion to vary the parameters during a trading day (and, if so, a description of the types of circumstances that would lead to the exercise of the discretion).

A marketplace should provide specific examples of how an order that triggers a Marketplace Threshold will be handled by that marketplace.

order is entered or would otherwise exceed the limits publicly disclosed by the Market Regulator for the exercise of the power of a Market Integrity Official under Rule 10.9 of UMIR.

Appendix B - Comments Received in Response to Rules Notice 12-0162 – Request For Comments – UMIR - Request for Comments on Marketplace Thresholds

On May 10, 2012, IIROC issued IIROC Notice 12-0162 requesting comments on Marketplace Thresholds (“Request”). IIROC received comments in response to the Request from:

Darrell Aldous (“Aldous”)
CNSX Markets Inc. (“CNSX”)
CIBC World Markets Inc. (“CIBC”)
Investment Industry Association of Canada (“IIAC”)
Scotia Capital Inc. (“Scotia”)

A copy of the comment letters received in response to the Request is publicly available on the website of IIROC (www.iiroc.ca under the heading “Notices” and sub-heading “Marketplace Rules – Request for Comments”). The following table presents a summary of the comments received in response to each of the questions posed in the Request and any general comments on the topic of Marketplace Thresholds together with the responses of IIROC to those comments.

Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
<p>1. As a result of recent experience in the U. S. with “erroneous trades” triggering Single-Stock Circuit Breakers, a number of commentators in the U.S. have suggested that standardized “limit up-limit down” volatility parameters be implemented at the market centre level. If adopted in the U.S., would there be a need for similar or “uniform” Marketplace Thresholds in the context of the Canadian market? In particular, would “uniform” Marketplace Thresholds be able to adequately take account of differences in trading patterns between large- and small-capitalization issuers on Canadian marketplaces?</p>	<p>Aldous – “Limit up-limit down” would not work well in Canada, particularly due to the number of low-float, illiquid small cap securities.</p> <p>CIBC – Favours a “limit up/limit down” approach that is harmonized with the US. If not harmonized, requests guidance from IIROC on whether orders could be sent to US markets when the Canadian circuit breaker is tripped. Suggests a 6 month review period after new circuit breakers are in place.</p>	<p>IIROC has similar concerns and it was for this reason that IIROC sought comment on the approaches to Marketplace Thresholds.</p> <p>A halt imposed by IIROC following the triggering of a “circuit breaker” is a regulatory halt which precludes execution on a marketplace or over-the-counter. In accordance with Rule 9.1(4) of UMIR, a trade may be executed during this type of regulatory halt outside of Canada on a foreign organized regulated market.</p> <p>If the mechanism for administering the Marketplace Thresholds on a particular marketplace involves a temporary halt or suspension of trading in a security that halt or suspension will be considered a “business halt” and trading may continue on other marketplaces.</p> <p>As a separate initiative, IIROC conducted a review of Single Stock Circuit Breakers and the parameters that may be applicable if Single Stock Circuit Breakers were to be extended to cover more listed securities. IIROC published</p>



Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
		for comment the results of its review together with its recommendations for expansion of the Single Stock Circuit Breaker program.
	<p>CNSX – Problems in implementing an approach in the US is due differences in trading patterns among listed securities. There is even greater diversity in Canadian listed securities. Believe there is no benefit to following the US “limit up-limit down” even for inter-listed issues.</p>	IIROC has similar concerns and it was for this reason that IIROC sought comment on the approaches to Marketplace Thresholds.
	<p>IIAC – Concerned that different standards may result in inefficiencies and opportunities for regulatory arbitrage. Members are split as to the best approach. Do note that as most ATSS have no opening call, a trading pause could be disruptive to ATS orders.</p>	Conceptually, Marketplace Thresholds should be established to preclude the execution of trades at a level of price movement that is less than what would be considered to be disruptive of a “fair and orderly market”. A trade that is disruptive of a fair and orderly market would “invite” the possibility of regulatory intervention by IIROC. Otherwise, trading in the particular security may continue on other marketplaces and that trading will help to demonstrate whether the price movement was justified in response to real supply and demand (or by an “erroneous” order).
	<p>Scotia – All things being equal, it would be good if the Canadian limits were roughly in line with US levels though this should not be the key consideration when setting Canadian levels or functionality. Uniformity across individual securities is not necessary. Should consider a combination of liquidity, volatility, capitalization and other considerations.</p>	<p>Unlike the situation in the United States, IIROC has always had and exercised a regulatory power to halt trading or to intervene to cancel or vary trades in the interest of a “fair and orderly” market. IIROC has issued guidance on the circumstances when IIROC would exercise its regulatory powers.</p> <p>Marketplace Thresholds do not perform a regulatory function but nonetheless need to be coordinated with the circumstances when IIROC would exercise its regulatory powers. If Marketplace Thresholds are a “business” feature, then they can be “tailored” to the trading of specific securities on a particular marketplace and take into account liquidity, volatility and other factors for the security overall but also the trading patterns of that security on the particular marketplace.</p>
<p>2. Should all marketplaces be required to adopt a form of “Marketplace Thresholds”? Should a marketplace that is not a “protected marketplace” be exempted if executions on that marketplace cannot occur outside of the spread between the “best bid price” and “best ask price”?</p>	<p>Aldous – Marketplaces should not be required to adopt a form of “Marketplace Thresholds”. Responsibility for “fat finger” check is on the dealer.</p>	<p>Dealers should already have in place “fat finger” checks for order entry. Effective March 1, 2013, this requirement was strengthened with the specific requirement for dealers to have automated pre-trade controls. Notwithstanding these requirements, IIROC still anticipates that a limited number of “fat finger” errors will slip through into the market. The purpose of Marketplace Thresholds is to act as a “backstop” for such fat finger errors but also to limit the impact of temporary liquidity imbalances when orders are being entered on the market concurrently from multiple sources.</p>



Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
	<p>CIBC – Recommends IIROC provide marketplace with strictly enforced uniform requirements.</p>	<p>The point of a regulatory framework for “Marketplace Thresholds” at the marketplace level and for “automated pre-trade controls” at the Participant level is that the requirements be principles-based with discretion to establish an “appropriate” level that in the ordinary course would preclude the execution of an order that would otherwise require regulatory intervention by IIROC. Since IIROC is providing increased transparency on the circumstances for regulatory intervention, those disclosed levels will establish the outside parameters for Marketplace Thresholds. In IIROC’s view, each marketplace should be able to establish its own system of thresholds which is appropriate for the type of trading occurring on its marketplace subject only to the fact that such thresholds should ordinarily preclude the execution of a trade that is beyond the price variation at which IIROC would consider regulatory intervention.</p>
	<p>CNSX – “Non-protected” marketplaces should be required to have them since in time of market turmoil one side of the market may fall away precipitously.</p>	<p>The comment is noted. However, IIROC would note that if the Marketplace Thresholds of each marketplace are performing appropriately, the spread between the best bid price and the best ask price should not reach levels that would invite regulatory intervention if a trade executed at either price. Since October 15, 2012, it should also be noted that trades on “non-protected” marketplaces must occur generally at a price which is better than the best bid price and best ask price.</p>
	<p>IIAC – All marketplaces should adopt to provide consistency and predictability. Non-protected marketplaces should not be exempted except when executions cannot occur outside the spread.</p>	<p>See response to CIBC and CNSX above.</p>
	<p>Scotia – Routers that spray portions of an order simultaneously to marketplaces in search of liquidity and best execution run the risk of creating trade-through situations if an execution is allowed to occur on some but not all marketplaces. Controls should be consistent among marketplaces. If the quote on a security has moved significantly from the last trade, a market could execute at a price that would not be permitted on a fully-protected venue.</p>	<p>From a regulatory perspective, a “trade-through” only occurs when a person intentionally ignores better-priced orders on other protected marketplaces. If the router sends orders to a particular marketplace there are a number of reasons why the order may not be executed, including the execution or cancellation of some or all of the displayed orders before the routed order arrives at the marketplace. If the routed order is a market order, executions could occur at prices which are considered disruptive to a fair and orderly market. IIROC would expect that the “marketplace threshold” would, in the ordinary course, preclude the execution of the order at which IIROC would consider regulatory intervention either through the triggering of a SSCB or under the Unreasonable Trade Policy.</p>



Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
<p>3. If marketplaces are allowed to adopt their own version of Marketplace Thresholds, are the “Suggested Guiding Principles” (set out in section 4 of this notice) appropriate? Are there are additional principles which should be considered?</p>	<p>Aldous – Suggests IIROC adopt a “maximum tightness threshold” that would be as lenient as possible to not interfere with normal price discovery.</p>	<p>The application of a “marketplace threshold” will only affect trading of orders on the particular marketplace. Trading on other marketplaces will continue thereby contributing to normal price discovery. If the problem is not “with the order” but a genuine response to supply and demand, the execution prices on the other marketplaces will continue to move which may lead to regulatory intervention by IIROC if the movements would interfere a fair and orderly market.</p>
	<p>CIBC – Not in favour of marketplaces adopting different standards “if this impedes the uniform application of the circuit breaker rules.”</p>	<p>SSCBs are a regulatory tool that IIROC uses to prohibit trading in a particular security across all marketplaces. Differences in Marketplace Thresholds between marketplaces will not have any effect on the operation of SSCBs.</p>
	<p>CNSX – First principle is appropriate but the second is problematic in that they “prescribe” a solution that will necessitate material systems changes not only at the marketplaces but on vendor and dealer systems.</p>	<p>There are alternatives to the “prescriptive” approach embodied in the second principle. As an administrative matter, IIROC has considered the first trade following a business halt to be an “Opening Order”. As such, the initial trade following the halt or freeze could be outside the prevailing spread at the time of the execution. IIROC could restrict the ability to execute outside the spread on the initial trade following the lifting of the freeze if the marketplace did not permit order cancellation and entry during the period of the freeze. In this way, any marketplace would have flexibility in designing their Marketplace Thresholds provided the initial trade was at or within the prevailing spread at the time of execution.</p>
	<p>IIAC – Principles are not sufficiently specific or binding in order to be effective. Should be uniform requirements to freeze or reject orders at the same levels across all marketplaces.</p>	<p>As contemplated, Marketplace Thresholds should be designed to operate based on price movements on a particular marketplace which are below the “regulatory” threshold when IIROC would invoke either a SSCB or consider intervention under IIROC’s Unreasonable Trade Policy. Similarly, each Participant under the amendments to UMIR respecting Electronic Trading is expected to have automated pre-trade controls that are tailored to its business and clients which would catch orders that, if executed, could be considered disruptive to a fair and orderly market. In Guidance, IIROC specifically noted that such controls should be designed to catch orders that would otherwise possibly trigger regulatory intervention. Just as IIROC does not expect the controls at each Participant to be identical, IIROC believes that each marketplace should be able to adopt Marketplace Thresholds that are appropriate for the type of trading activity conducted on that marketplace. Despite the best efforts of Participants and marketplaces, IIROC recognizes that there will be circumstances when regulatory intervention by IIROC will nonetheless be required.</p>



Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
	Scotia – While agrees with the concepts, the guidelines alone will not create enough of an incentive for marketplaces to have the same standards or to harmonize the approach.	See response to IIAC above.
<p>4. If marketplaces are allowed to adopt their own version of Marketplace Thresholds, should:</p> <p>(a) “freeze parameters” be required to provide for order cancellation during the period of the freeze (such that liquidity does not get “trapped” on a marketplace or “taken advantage of” on the lifting of the freeze in a rapidly moving market)?</p>	Aldous – Orders should not be allowed to be cancelled during a freeze. Cites the example of price movement on the release of news.	Order entry, variation and cancellation are permitted during a regulatory halt in trading (which includes a halt for the dissemination of material news). The problem with the inability to cancel orders during a marketplace “freeze” is that trading is continuing on other venues and the orders in the book could be taken advantage of upon the resumption of trading.
	CIBC – Yes. “Trapped” liquidity should have an opportunity to exit.	IIROC acknowledges the comment.
	CNSX – Aware of the “unintended trading results” that may arise under the current freeze functionality. CNSX is investigating solutions but do not want to be constrained by “a particular approach prescribed by IIROC”.	IIROC recognizes that there may be alternatives. For example, IIROC could provide that the initial trade following the release of a “freeze” must be within the context of the NBBO at the time the freeze is lifted unless order entry, amendment and cancellation are permitted during the period of the freeze.
	IIAC – Participants should be able to cancel orders that are in the queue so that subsequent intervention is not necessary.	IIROC acknowledges the comment. See also the response to CNSX above.
	Scotia – Yes.	IIROC acknowledges the comment.
<p>4. If marketplaces are allowed to adopt their own version of Marketplace Thresholds, should:</p> <p>(b) “freeze parameters” be required to provide for order entry during the period of the freeze (so that any additional liquidity would have an opportunity to enter and stabilize prices)?</p>	Aldous – Orders should not be allowed to be entered during the time of the freeze as this will be used as a gaming tool.	Provision for order entry, amendment and cancellation during a “freeze” should allow the prices on that marketplace to move to approximate the movement in prices on other marketplaces during the period of the freeze.
	CIBC – Yes. Makes the structure more consistent with US “limit up-limit down”.	The purpose of the Marketplace Thresholds is not to constrain true price discovery which is a temporary by-product of the “limit up-limit down” mechanism. In IIROC’s view, if the price of a security continues to move on other marketplaces, it should be allowed until such time that the movement reaches levels that would warrant regulatory intervention. If the price of a security is moving based on material news which has been properly disseminated, IIROC believes that the price movement should be permitted.
	IIAC – Yes.	IIROC acknowledges the comment.
	Scotia – Yes, provided that new orders do not also violate the threshold levels.	See response to CIBC above. The freeze is providing the opportunity for market participants to “take stock”. If the price should continue to move



Text of the Question in the Request	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
		based on market sentiment or news, IIROC believes that it should be permitted. The freeze merely provides an opportunity to confirm whether the order which triggered the freeze is “bona fide” or “erroneous”.
<p>4. If marketplaces are allowed to adopt their own version of Marketplace Thresholds, should:</p> <p>(c) “freeze parameters” be limited as to how long they may be in effect for a particular security (to provide greater certainty to marketplace participants)?</p>	<p>Aldous – Believes freezes are a bad idea but if permitted the less time that a freeze is in place the better to allow the markets to function without interference. Suggests a one minute maximum.</p> <p>CIBC – Clearing the freeze is currently a manual process. Prefer the “automated and predictable response” of the limit up-limit down.</p> <p>CNSX – Believes time limits are unduly prescriptive and may not allow the marketplace sufficient flexibility to deal with unusual conditions.</p> <p>IIAC – Would support the provision but it is important that marketplaces notify Participants if there is such a time limit.</p> <p>Scotia – Yes, but if there is no limit marketplace should have an obligation to message or contact the Participant. A market should have the ability to request that IIROC extend the freeze.</p>	<p>The need for a time limit is predicated on the functionality of the “freeze parameters”. If orders can be entered, varied and cancelled during the period of the freeze on a particular marketplace and trading is continuing on other marketplaces then the need for a time limit is reduced.</p> <p>As Participants are now required to have specific filters to monitor orders prior to entry on a marketplace, the incidence rate of “freezes” should decrease at least in respect of securities that are relatively-liquid to highly-liquid. In the context of the listed securities in the Canadian market, the majority of such securities are relatively-illiquid to highly-illiquid for which trade prices can show significant discontinuity. “Limit up-limit down” is predicated on additional liquidity entering the market within a short period of time (15 seconds). That approach has no practical application to the trading patterns of a majority of Canadian listed securities.</p> <p>IIROC acknowledges that time limits would be “prescriptive” but to the extent that order entry and cancellation may not be permitted during the freeze, the imposition of the time limit would offset at least partially the possible harm to “trapped orders”. See also the response to CNSX for 4(a) and 4(b) above.</p> <p>IIROC expects that Participants will consider the Marketplace Thresholds when setting parameters for monitoring of order flow as required by the Electronic Trading amendments. If thresholds are dynamic, marketplaces will not be able to provide precise values but IIROC would expect that each marketplace would be transparent on the key features of their Marketplace Thresholds.</p> <p>The purpose of the “freeze” is to allow the marketplace time to confirm the bona fides of the order with the Participant or Access Person that entered the order that triggered. Since the contact is the responsibility of the marketplace, the marketplace rather than IIROC is probably in the better position to determine if the freeze should be extended. In this eventuality, IIROC would expect that the marketplace would broadcast a further message on its broadcast feed.</p>
<p>4. If marketplaces are allowed to adopt their own</p>	<p>Aldous, CIBC and IIAC – Yes.</p>	<p>IIROC acknowledges the comment.</p>



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<p>version of Marketplace Thresholds, should:</p> <p>(d) “rejected orders” be required to carry a message as to the reason for rejection so that the order could not be automatically re-routed to another marketplace without intervention from the Participant or Access Person who entered the order?</p>	<p>IIAC and Scotia – Necessary so that a Participant can take appropriate actions in respect of any remaining portion of the order.</p> <p>CNSX – Would require “significant and coordinated programming effort”. The same result can be achieved with the automatic cancellation of a “freeze inducing” order without the need of a protocol and functionality change.</p>	<p>IIROC acknowledges the comment.</p> <p>IIROC’s objective is to allow flexibility in providing Marketplace Thresholds provided the threshold does not operate in a manner that impinges on market integrity. The suggestion offered is not one currently used by the marketplace using “reject” functionality but IIROC recognizes that one of the guiding principles should be the design of Marketplace Thresholds in a manner which minimizes the regulatory burden on other entities to facilitate the functionality of the Marketplace Thresholds adopted by a particular marketplace.</p>
<p>5. How should “directed-action orders” be treated under Marketplace Thresholds? Should the obligation to ensure that the order is “acceptable” (e.g. the execution price would be below the volatility parameters of the marketplace on which the order is entered and below the threshold for regulatory intervention by IIROC) be borne by the party that marked the order as a “directed-action order” (whether that be the Participant or Access Person that entered the order on the marketplace that marked and re-routed the order pursuant to the Order Protection Rule)?</p>	<p>Aldous – Obligation should be borne by the party that marked the order as a “directed-action order”.</p> <p>CIBC – If a marketplace were to allow a Participant to opt out of that marketplace’s thresholds should be considered a business decision for both parties.</p> <p>CNSX, IIAC and Scotia – No need to treat orders marked DAO differently.</p>	<p>If thresholds apply to directed-action orders, it is possible that executions will be prevented that would otherwise be required in order to move the market price to a level that would be necessary to facilitate executions on another marketplace without “trading through”. If the Marketplace Threshold precluded the execution of a directed-action order, the Participant or Access Person would have an obligation to re-enter the balance of the order or otherwise authorize its execution in order to comply with the requirements of the Order Protection Rule.</p> <p>The role of Marketplace Thresholds is to preclude the execution of trades that would otherwise require regulatory intervention. IIROC is therefore concerned that a “voluntary opt out” would merely lead to more interventions by IIROC than would otherwise be required.</p> <p>IIROC acknowledges the comment. IIROC would also note that any order being entered by the Participant or Access Person, including a directed-action order, is subject to the pre-entry automated controls mandated by the Electronic Trading amendments to UMIR that became effective March 1, 2013.</p>
<p>6. What types of orders should be covered by Marketplace Thresholds? Should they cover all orders:</p> <ul style="list-style-type: none"> • entered on a marketplace; • that on execution would establish the “last sale price” (thereby excluding: Basis Orders; Call Market Orders; Closing Price Orders; certain Special Terms Orders and Volume-Weighted Average Price Orders); 	<p>Aldous – Believes all thresholds will be gamed. In the rare case that a security does trade at an unacceptable price the trade can be expunged and re-priced as is currently done.</p> <p>CIBC – Opening Orders and Market-on-Close Orders should have unique thresholds set independently of the thresholds for open market trading.</p>	<p>The purpose of Marketplace Thresholds is to limit the number of occasions that trades actually occur at an “unacceptable price” that would require IIROC to intervene to vary or cancel the trade or trades.</p> <p>Marketplaces will have flexibility in the establishment of Marketplace Thresholds and each marketplace may decide to have separate thresholds for these types of orders. The existing Market-on-Close facilities offered by the TSX and TSXV have a volatility parameter that if exceeded leads to a “price movement extension” and then a further Closing Price Acceptance parameter. No marketplace presently has set parameters to preclude executions of</p>



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<p>or</p> <ul style="list-style-type: none"> that would establish the “best ask price” or “best bid price” (thereby excluding orders that do not establish the “last sale price” together with Opening Orders and Market-on-Close Orders)? 		Opening Orders. The reason for this has been the fact that Opening Orders reflect “overnight news”. Exchanges with formal market makers have empowered the market makers to delay opening if the price is unreasonable (based on market conditions).
	<p>CNSX – Should exclude orders that do not establish “last sale”. Suggests “odd lots” be excluded.</p>	IIROC acknowledges the comment. IIROC would also note that “odd lots” do not establish “last sale” price.
	<p>IIAC – All orders should be covered.</p>	As noted by CIBC, including certain types of orders would necessitate “unique thresholds set independently” for various types of “special” orders.
	<p>Scotia – Orders that establish a last sale price should be included. Orders that would establish a bid price or ask price outside the threshold should not be allowed and should be subject to the marketplace threshold.</p>	IIROC acknowledges the comment.
<p>7. The proposed National Instrument 23-103 contemplates that a regulation services provider may establish both “price and volume thresholds”. If an order would have a significant impact on the market price beyond the threshold established by IIROC, Marketplace Thresholds would be expected to preclude the execution of the order. If an order would not have a significant impact on the market price on execution, should Marketplace Thresholds limit or preclude the ability of such order to trade simply because of the size of the order?</p>	<p>Aldous – Should not interfere with large orders that do no significantly impact price.</p>	IIROC acknowledges the comment.
	<p>CIBC – Single order volume thresholds are reasonable to protect from “fat finger” mistakes. Complications of volume errors have the potential to go beyond simply impacting price.</p>	The pre-entry controls required of Participants and Access Person under the Electronic Trading amendments that became effective March 1, 2013 did address this matter. In the view of IIROC, these controls on volume are properly at the level of the Participant as only the Participant can accurately determine if the volume of the order is “erroneous” in the context of the trading patterns of the client.
	<p>CNSX – Will be addressed by many market participants in the context of the Electronic Trading Rule.</p>	See response to CIBC above.
	<p>IIAC and Scotia – Marketplace thresholds should be comprised of both price and volume parameters.</p>	See response to CIBC above.
	<p>Scotia – Would suggest an exception for cross orders recognizing that UMIR provides methodology a Participant must use to facilitate a cross that would impact market prices.</p>	The parameters for what is expected of a pre-arranged trade or intentional cross are presently set out as Part 2 of Policy 2.1 of UMIR.
<p>8. Should Marketplace Thresholds be more flexible during periods of “natural volatility” (e.g. in the twenty minutes following the regular opening and for the last thirty minutes</p>	<p>Aldous – “Flexible” thresholds should apply all the time.</p>	IIROC acknowledges the comment.
	<p>CIBC – Concerned that a 5-minute pause at 3:35 could interfere with the TSX MOC imbalance dissemination at</p>	A freeze in the TSX/TSXV “regular” book does not impact the operation of the MOC. A regulatory halt imposed by IIROC (including one from the triggering of a circuit breaker) prevents executions during the period of the halt but does



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<p>before the close of regular trading, being the periods when the Single-Stock Circuit Breaker would not be triggered)?</p>	<p>3:40. Care should be taken to ensure that MOC is not disrupted by a circuit breaker event. Recent events in US have illustrated that some form of protection in the minutes after the regular opening should be considered using a larger volatility parameter.</p>	<p>not prevent a marketplace from allowing order entry, variation or cancellation in either the “regular” book or the MOC facility.</p>
	<p>CNSX – Experience with present “freeze” functionality is that majority occur early in the trading day. Concerned with a system where marketplace thresholds are triggered so often as to have their use restricted early and late in the trading day.</p>	<p>In a separate initiative, IIROC is proposing to expand the application of SSCBs to a slightly broader range of securities (including “actively-traded” securities) and to extend the period of the application to the period of the “regular” trading day (from 9:30 to 4:00). The liquidity of the securities that would be covered by the SSCB is such that a “triggering” price movement will be a relatively uncommon event. For approximately 90% of securities, IIROC would use its guidance on regulatory intervention for the variation and cancellation of trades rather than a SSCB and, in these cases, IIROC recognizes that the Marketplace Threshold may measure price movement based on either the last sale price or the closing price of the previous trading day.</p>
	<p>IIAC – Should not vary throughout the day unless the thresholds provide for wider variance during such periods.</p>	<p>See response to CNSX above. However, IIROC recognizes that there are distinctly different trading patterns for those securities which will not be covered by SSCBs. IIROC is recommending that marketplaces be able to take account of periods of “natural volatility” in the design of their Marketplace Thresholds based on the trading patterns for the securities traded on that marketplace.</p>
	<p>Scotia – Believes may be value in varying the thresholds during periods of natural volatility.</p>	<p>See response to IIAC above.</p>
<p>General Comments</p>	<p>Aldous – The lifting of freezes usually on the TSX or TSXV often results in a trade-through of bids and offers on other marketplaces that were not frozen. Suggests one of three solutions:</p> <ul style="list-style-type: none"> • every market use the “reject” method, • marketplaces co-ordinate “freezes” (similar to halts), or • only the dealer who “froze” the security is contacted to confirm validity of the order. 	<p>The use of the “reject” method is fraught with its own difficulties if erroneous orders are simply rerouted to other marketplaces for execution.</p> <p>By their nature, “freezes” are far more likely to occur than regulatory halts. This is particularly true with the trading of securities with restricted liquidity when there can be significant price dislocation when a person is attempting to execute what is considered a “sizable” order for the particular security. That is the reason, the freeze parameters employed by the TSX and TSXV are “dynamic” in nature taking into account the liquidity profile of the particular security.</p>
	<p>CIBC – Concerned that arbitrary and static threshold create ambiguity which has the potential to discourage liquidity provision. Current controls only protect from a single “fat</p>	<p>As noted in the Request for Comments, each of the industry participants has a role to play. The Electronic Trading provisions have elaborated on the obligation of Participants for monitoring orders prior to entry to a</p>



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	<p>finger” error. Believes that there should be secondary measures to detect amplified trading activity that may result in a pause in trading.</p>	<p>marketplace. Marketplace Thresholds are the second level of monitoring which, at a minimum should be aimed at preventing the execution of “fat finger” and “clearly erroneous” orders.</p>
	<p>CNSX – Marketplace thresholds can be an important tool in maintaining fair and orderly markets and in promoting investor confidence. A sound business practice that can be lined to the market model, technology and system architecture deployed by the marketplace. A standard approach is not in the best interests of the industry. Market regulator should set out principles or guidelines that are not overly prescriptive. Investor protection measures implemented as a consequence of the Electronic Trading Rule may well work in tandem with marketplace thresholds to deliver a higher standard of operation.</p>	<p>The requirements for automated pre-trade controls imposed on Participants under the Electronic Trading provisions are principles-based, allowing each Participant to tailor the controls to the types of businesses and clients. Similarly, IIROC believes that each marketplace should be able to fashion their thresholds for types of trading which occurs on that marketplace. When the trading activity is of a nature which is interfering with a “fair and orderly market”, the criteria for regulatory intervention should be standard and apply across all marketplaces trading the particular security.</p>
	<p>Scotia – Marketplace thresholds should have the least amount of impact on the operation of price discovery and access to “tradable” liquidity. Inconsistent thresholds between markets can cause significant unintended consequences for smart-routed orders and result in increased volatility. In light of recent events, would suggest IIROC consider unusual trade and/or order activity level thresholds for marketplaces. Not proposing limits that would in any way replace an individual Participant’s responsibility to actively test, control and monitor algorithms. However, suggest that the marketplace should be able to detect and halt trading if highly unusual activity levels are detected for some sustain period. Would need to be set high enough and would need to allow for the market to digest news and other events.</p>	<p>In the Request, IIROC recognized that the current volatility controls employed by some marketplaces had “shortcomings”. Underpinning the principles which IIROC suggested in the Request is the goal of protecting the price discovery mechanism while ensuring the greatest possible access to “tradable” liquidity. IIROC recognizes that there may be alternative methods to achieve these objectives. For this reason, IIROC is proposing to revise the second suggested principle to be less prescriptive and to allow flexibility to marketplaces in the design of their Marketplace Thresholds.</p>