



October 23, 2020

**VIA EMAIL**

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Dear Sirs/Mesdames.

**Re: CSA Consultation Paper 25-402 *Consultation on the Self-Regulatory Organization Framework***

TMX Group Limited (“**TMX**” or “**we**”) welcomes the opportunity to comment on the CSA’s public consultation on the self-regulatory organization (“**SRO**”) framework (the “**Consultation Paper**”) that was published on June 25, 2020. We appreciate the efforts taken by the CSA to reflect on how the evolution of the financial services industry has impacted the current regulatory framework in Canada.

**TMX Group and SROs**

TMX’s key subsidiaries operate cash and derivatives markets for multiple asset classes, including equities and fixed income, and provide clearing facilities, data driven solutions and other services to domestic and global financial and energy markets. Toronto Stock Exchange, TSX Venture Exchange, TSX Alpha Exchange, the Canadian Depository for Securities, Montreal Exchange, Canadian Derivatives Clearing Corporation, Shorcan Brokers Limited and other TMX companies provide listing markets, trading markets, clearing facilities, data products and other services to the global financial community and play a central role in Canadian capital and financial markets.

The TMX equities exchanges retain the Investment Industry Regulatory Organization of Canada (“IIROC”) as a regulation services provider to monitor the trading activities on our equities exchanges by enforcing compliance with the Universal Market Integrity Rules. Given our familiarity with IIROC operations, we focus our comments on Issues 6 and 7 in the Consultation Paper.

## **Issue 6: Public Confidence in the Regulatory Framework**

### Targeted Outcome Statement (Issue 6)

TMX supports the targeted outcome statement for this section of the Consultation Paper: “A regulatory framework that promotes a clear, transparent public interest mandate with an effective governance structure and robust enforcement and compliance processes.”

We believe that IIROC is operating squarely within this framework. We believe that a MFDA-IIROC merger would not necessitate any fundamental changes in the CSA’s oversight of the amalgamated SRO in order for the operations currently performed by IIROC to continue to meet this targeted outcome.

### Summary of Stakeholder Comments

In response to stakeholder comments summarized in this section of the Consultation Paper, we disagree with the implication that inadequate oversight of the SROs is resulting in unmanaged conflicts of interest with a risk of loss of confidence in the SROs’ ability to meet their public interest mandate. In our view, IIROC, including its governance structure, is heavily regulated by the CSA and further intervention by the CSA in IIROC’s governance processes would be an unnecessary burden.

An example of a concern raised by a stakeholder is that the CSA does not appoint or have veto rights over SRO board members or key executive staff and that the CSA does not hold a seat on the SRO Board. In our view, permitting the CSA to veto key SRO appointments and enabling the CSA to appoint any directors to an SRO board of directors would be extremely burdensome and time consuming to manage, without commensurate benefit. TMX would have significant concerns if this kind of CSA intervention were applied to IIROC’s Board selection process. From a governance perspective, we understand that IIROC already has a sophisticated skills matrix that it uses when it identifies candidates for its board. We expect that the IIROC Board matrix would include, at a minimum: industry experience - large dealers and smaller, independent dealers as well as marketplaces; directors who are independent from members and marketplaces; individuals with one or more of financial, legal, governance, technology and operations expertise; representatives from different Canadian geographic locations, appropriate representation of women, Black people, indigenous people and people of colour. This is just a sample list of the various skills, expertise and experiences that IIROC would likely seek for its Board. We do not believe that CSA staff or management would be better placed than IIROC’s Board and management to select the IIROC Board members, and are concerned that creating a new process to require IIROC’s thirteen regulators to jointly appoint IIROC Board members could add significant delay to IIROC’s director onboarding process, with no commensurate benefit. Finally,

we submit that the CSA struck the proper balance between its need for regulatory oversight and IIROC's need for commercial and operational flexibility when the CSA set out in the applicable recognition orders detailed criteria for IIROC's board composition. Given that the IIROC board members ultimately owe their fiduciary duty to IIROC when they are considering IIROC business, we do not understand the benefit that would accrue to IIROC if the CSA were to select certain IIROC directors.

In conclusion on this topic, we disagree with the notion that the regulatory oversight related to the governance of SROs needs to change. We believe that the current governance structure at IIROC, for example, appropriately manages potential conflicts of interest and that IIROC is able to fulfil its public mandate efficiently and effectively under its current corporate governance framework.

### **Issue 7: The Separation of Market Surveillance from Statutory Regulators (CSA)**

#### Summary of Stakeholder Comments

This section of the Consultation Paper states that certain stakeholders raised concerns about possible information gaps and fragmented market visibility resulting from market surveillance functions being separated from the CSA. This section of the Consultation Paper contains very little information about the rationale that could support the stakeholders' comments. Contrary to the stakeholder comment references relating to Issue 7, TMX does not share these concerns. Based on our first-hand knowledge of IIROC's equity market surveillance work, we believe that maintaining the equities markets surveillance operations at IIROC is important for the continued fair and efficient operations of the Canadian public equities market.

Before we address the specific stakeholder comments that are raised in this section of the Consultation Paper, we believe that it is important to reiterate the benefits and strengths of the SRO model that were identified during the CSA's information consultations and are summarized in the Consultation Paper. In our view, these benefits, and IIROC's continued exemplary performance, support the position that IIROC, or its successor organization, should continue to fill the equity market surveillance role and that no further intervention by the CSA is required. The Consultation Paper states that numerous stakeholders agreed that the national structure of an SRO is important in light of the provincial and territorial regulation of the securities industry in Canada. TMX agrees that a national SRO provides consistency and efficiencies that would be lost in a more fragmented model. We also agree that IIROC's use of advisory committees and industry-related expertise enables it to stay abreast of trends that support policy formation.

#### IIROC's Surveillance Mandate contributes to Market Efficiencies

To support our perspective that IIROC's operations are integral to our capital markets and that maintaining equities trading surveillance at IIROC is important, we provide data that shows the efficient operations of IIROC in recent times of market stress and volatility.

In March 2020, the Canadian equities markets saw extreme and elevated levels of trading activity due to investors' reactions to the Covid-19 pandemic and related economic events. Despite this atypical market activity and amid business continuity plans that saw a large number of staff shift from an office environment to work-from-home, our markets functioned well and without disruption. IIROC continued to process the messages from Canadian marketplaces in real-time and maintained its ongoing surveillance of the market despite the fact that the number of orders processed in March were significantly higher than in previous months, as is shown by TMX trading statistics:

- The number of orders processed by TSX on an average day in March was over 3.5 times greater than the number of orders prior to March
- March daily volumes on TSX were over three times greater than prior to March
- TMX equity marketplaces reached a daily peak number of messages in March that was double the previous daily peak

The above data, and the fact that the market functioned well and without disruption, is illustrative of the resiliency of Canada's trading ecosystem, which includes dealers, marketplaces, post-trade infrastructures, and IIROC in its role as market surveillor.

It is also relevant to note that a number of trading "safety nets" were used during the first quarter of 2020. These market mechanisms that were built to manage extreme volatility, functioned as designed and helped to moderate unnecessary market turmoil, thus protecting investors. We provide statistics related to these market mechanisms below, as a reminder that not only did IIROC's surveillance capabilities match unprecedented trading volumes in the first quarter of 2020, but that tools that are designed to be used only on an exceptional basis to moderate activity during periods of extreme volatility were successfully engaged earlier this year:

- Four market-wide circuit breakers ("**MWCBs**") were triggered in March. (The last time a MWCB was triggered was in October 1997 when the Canadian market reacted to the Asian economic crisis.)
- 72 single-stock circuit breakers ("**SSCBs**") were triggered on TSX in Q1 2020. (By comparison, 10 SSCBs were triggered during all of 2019.)

We believe that the above data is illustrative of the efficiency that IIROC brings to the market and supports our view that the equities market surveillance function should remain at IIROC. Similarly, in our discussions with clients that are regulated by IIROC, we have not heard support for the proposition that the CSA should take over market regulation functions. Rather, we have heard skepticism that the group of provincial regulators could operate market surveillance as effectively as IIROC.

Targeted Outcome Statement (Issue 7)

Question 7.2 in the Consultation Paper asks if the targeted outcome for Issue 7 is described appropriately: “An integrated regulatory framework that fosters timely, efficient access to market data and effective market surveillance, to ensure appropriate policy development, enforcement and management of systemic risk.”

We believe that this targeted outcome statement is overly broad as currently written.

One concern is the use of the phrase “management of systemic risk”, which we submit should be removed from a targeted outcome statement that is related to the oversight and operation of SROs. Based on our view of securities law, it does not seem to be the CSA’s role to “ensure...management of systemic risk”. The Ontario *Securities Act* first added a reference to systemic risk three years ago, when it was amended to include in its purpose section, “... to contribute to the stability of the financial system and the reduction of systemic risk”<sup>1</sup>. We believe that this purpose is most directly related to the OSC’s oversight of entities such as clearing houses whose systems have been designated to be systemically important. We also note that having a purpose to contribute to the reduction of systemic risk is very different from ensuring that systemic risk is managed. It is also important to note that, unlike the Ontario Securities Commission, few CSA members include any reference to systemic risk in their governing legislation. The fact that the majority of CSA members do not reference systemic risk at all in their legislation raises the question of whether reduction of systemic risk should be used in any CSA targeted outcome statement.

Further, we believe that the term “systemic risk” is not being used correctly in the targeted outcome statement. Systemic risk in a financial context denotes the risk of a cascading failure in the financial sector, caused by linkages within and between the components of the financial system, resulting in a severe economic downturn.<sup>23</sup> While TMX fully agrees that the fair and efficient operation of our public equity markets facilitates vital capital formation activities and is integral to investor confidence, we do not believe that it is correct to imply that marketplace trading activities are possible triggers of systemic risk, properly understood. For these reasons, we submit that reference to systemic risk be removed from this targeted outcome statement.

We accept that the other aspects of this targeted outcome statement are appropriate. In particular, we agree that marketplace data can be used to support policy formation and is necessary for the enforcement of securities law. We also accept the proposition that the regulatory framework should foster timely and efficient access to market data. It is worth noting that this statement does not further define “timely”. This is appropriate because not all market oversight requires access to real-time data. For example, data that would assist IIROC or the provincial securities regulators in investigations related to market manipulation or insider trading is compiled from trading records

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<sup>1</sup> *Securities Act* (Ontario), R.S.O. 1990, c.S.5, section 1.1(c)

<sup>2</sup> <https://www.cfainstitute.org/en/advocacy/issues/systemic-risk>

<sup>3</sup> See also the definition of systemic risk in the *Payment Clearing and Settlement Act*, S.C. 1996, c. 6, section 2.

over multiple trading sessions, thus making the ability to efficiently access data much more relevant than the speed at which the raw data is originally received.

In summary, we submit that this target outcome statement could be improved by removing the reference to systemic risk, for example: “An integrated regulatory framework that fosters timely, efficient access to marketplace data and effective market surveillance, to ensure appropriate policy development and enforcement of securities laws and SRO rules”.

#### TMX Response to Issue 7, Comment 1

*Comment 1: “The MFDA expressed concerns regarding the ability of statutory regulators to effectively monitor systemic risk and inform market structure policy without sufficient expertise and direct access and control over market data.”*

Consistent with our discussion of systemic risk in the section above, we submit that the MFDA’s use of the term “systemic risk” is incorrect in this context. An SRO regulates the operations and the standards of practice and business conduct of its members or participants. The statutory regulators then oversee these SRO activities.<sup>4</sup> The statutory regulators are not using the SROs to monitor systemic risk.

The MFDA’s second concern is whether the CSA has sufficient expertise and sufficient access and control over market data to inform the development of market structure policy. TMX does not share the MFDA’s concern. We strongly support data-driven policy formation, and we have seen enhanced capabilities over the years at IIROC and with the CSA members, to structure themselves in a way that enables them to use data and analytics to support policy formation. In response to the comment on “sufficient expertise”, we have found that certain staff members in the CSA have considerable experience and expertise on equities market structure matters, including by participating in international policy development, and we have found that the skill sets at IIROC and the CSA are complementary in this regard.

#### TMX Response to Issue 7, Comment 2

*Comment 2: “An investor protection fund raised a question about the integration of member and market surveillance in an SRO and the potential for conflicts that could possibly arise between the obligations respecting the disruption to markets and maintaining market integrity versus exposure to the investing public.”*

We find this comment confusing given that IIROC as an SRO already performs both a member conduct oversight function and a market surveillance function. IIROC’s oversight of trading activity and member conduct is designed to support fair, efficient and orderly markets as well as foster appropriate member conduct toward clients. In both cases, investors are the beneficiaries of IIROC’s oversight. We do not consider member and market regulation to be in conflict.

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<sup>4</sup> See for example, *Securities Act* (Ontario), R.S.O. 1990, c.S.5, section 21.1(3) and *Securities Act* (British Columbia), RSBC 1996, chapter 418, section 26(1).

### TMX Response to Issue 7, Comment 3

Comment 3: *“The MFDA also questioned the appropriateness of the current market surveillance structure and whether the CSA ought to play a larger role. The SRO noted that IIROC and the CSA enforcement processes might be less effective, inefficient, and more costly as a result of the duplication of surveillance and data analysis efforts between IIROC and the CSA.”*

TMX supports the application of intelligent regulation and efficient oversight. We are not aware of a duplication of efforts in the area of investigations and enforcement actions as between IIROC and the CSA. To the contrary, our understanding is that for matters of provincial jurisdiction such as insider trading, IIROC’s systems alerts and analytic tools are being used to identify potential misconduct, and arrangements are in place between IIROC and the CSA to enable the provincial regulators to further investigate and refine elements of a potential enforcement action. If there are existing inefficiencies in this area, these could be addressed by enhanced communication and a clearer delineation of roles.

In conclusion on this Issue 7, TMX would strongly resist any actions that would move the equity market surveillance function from IIROC to the CSA. We believe that an appropriate targeted outcome related to market surveillance can be achieved while retaining market surveillance functions within the amalgamated SRO.

### **Conclusion**

We thank the CSA for providing us with the opportunity to comment on the Consultation Paper. As staff reviews the comment letters and as the CSA prepares for a potential merger of the MFDA and IIROC, we urge the CSA to be vigilant in protecting the existing efficiencies at IIROC, in particular as regards IIROC’s market surveillance role. We would be pleased to discuss our comments with you.

Sincerely,



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