

July 25, 2014

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (NB)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

The Secretary
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Me Anne-Marie Beaudoin, Corporate Secretary
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Re: Request for Comments on the Canadian Securities Administrators (CSA) Proposed Amendments to National Instrument 21-101 *Marketplace Operation* and National Instrument 23-101 *Trading Rules*

Dear Sirs/Mesdames:

Chi-X Canada ATS Limited (“Chi-X Canada” or “we”), operator of Chi-X Canada ATS and CX2 Canada ATS marketplaces welcomes the opportunity to provide comments on CSA’s Proposed Amendments to National Instrument 21-101 *Marketplace Operation* (“NI 21-101”) and National Instrument 23-101 *Trading Rules* (“NI 23-101”) (“Proposed Amendments”).

We commend the CSA in the preparation and publication of the Proposed Amendments which reflect an awareness of new developments, domestic and international, arising in risk management and market structure. In particular, we recognize the importance placed on marketplace systems and electronic trading. We also note the introduction of new requirements related to cybersecurity controls. Given recent incidents where several multinational corporations and government agencies have experienced a breach, we believe this threat continues to be of central importance to the safety of our capital markets.

The CSA continues to harmonize regulation for trading services between recognized exchanges and approved alternative trading systems (ATSs). We support this approach given that exchanges and ATSs compete for the same services and that ATSs have proven to be significant to the market ecosystem (ATSs being able to capture significant market share since the introduction of competition) and both engage IIROC to perform market surveillance. It is for this reason that we believe Proposed Amendments have omitted a key amendment that continues to create regulatory differences between ATSs and exchanges – removing the requirement for an ATS to be registered as an Investment Dealer.

The ATS rules were first introduced in 2001 to foster competition with the incumbent exchange. At this time, ATSs were required (and continue today) to be registered as Investment Dealers largely because the OSC did not have formal authority over ATSs. If an ATS did not comply with guidance from the Commission, its registration could be revoked. Since this time, the requirements for ATSs and exchanges have been almost identical: each now follows a similar change protocol including at times a public comment period; both are required to comply with transparency of operations requirements and both are subject to the same approval process for the introduction of new or changed fees, order types and services. As the proposed amendments to the Order Protection Rule indicate (proposed to only protect quotes on marketplaces which has achieved a 5% continuous auction matching market share) the significance of a marketplace is now derived by its market share and not its regulatory recognition status.

Continuing to require ATSs to be registered as Investment Dealers results in certain unnecessary regulatory differences between ATSs and exchanges and differenced in the regulation fees that each pay. Unlike exchanges, ATSs are subject to IIROC Dealer Member Rules because they are required to be IIROC member dealers. Consequently, not only are ATSs responsible for compliance with many rules that are not applicable to their business but are also responsible for complying with rules that are not applicable to exchanges. Additionally, being required to be a registered investment dealer an ATS is subject to additional fees that are not applicable to exchanges. ATSs must pay IIROC member and registration fees as an IIROC dealer-member. They are also responsible for paying provincial regulatory fees as an investment dealer that do not apply to exchanges unless they are publicly listed in which case a different fee schedule is used for determination.

In 2010 the OSC was given authority over ATS, making the original rationale for requiring registration unnecessary. Given that this requirement creates regulatory differences between the ATSs and exchanges, and that the CSA has taken steps to harmonize the regulatory framework for these two types of marketplaces, we question why this requirement is being maintained. We strongly urge the CSA to consider removing this requirement or create an alternative “exchange light” category whereby a marketplace that does not list securities can be registered as an exchange but be responsible for fewer requirements than apply to an exchange supporting a listing business. This will remedy the unfair practice today and in turn serve to improve the quality of the market.

Our specific comments to Proposed Amendments are provided below:

Specific Comments

I. Marketplace systems and business continuity planning

(i) Business Continuity Testing

Compulsory participation in industry wide BCP test – Given the interconnection and dependencies of participants, vendors, marketplaces and clearing agencies involved in the lifecycle of a trade, we support

mandatory participation of *all* critical stakeholders in an industry wide BCP and DRP test. A coordinated approach not only ensures that recovery testing takes place for all relevant parties, but also allows for the identification of issues originating from connections between entities that may not have been identified in a test done in isolation. **We strongly encourage the CSA to mandate a marketplace’s production environment for participation in this industry wide test.** Using a test environment significantly undermines the effectiveness of a BCP test as many participants are not connected to all test environments and are unable to validate or identify issues with the marketplace that is relevant to ensure the continuation of business with/at that marketplace.

Mandated recovery times for critical systems for significant marketplaces (over 10 percent value in a security) – Although including target recovery times in risk management and business recovery policies and procedures has merit as good practice, it is impossible for any technology provider to ensure that recovery will take place within a predefined time period. This reality is expressed commercially in that contracts set out service level agreements (SLA) often with response times that lead to escalation procedures if an issue is not resolved within a predefined SLA target time. Failing to meet a target recovery time can be caused by a number of factors outside of a technology providers control including dependency on a third party provider and that the nature of a software or hardware issue that can have wide impact. In certain circumstances there could be more risk posed to market integrity by a marketplace operator opening to soon when an issue has occurred rather than remaining closed for the day.

The Proposed Amendments require a marketplace with a market share of equal to or greater than 10% in the value of a type of security during at least two of the preceding three months of operation to ensure that each critical system can resume operations within two hours following the declaration of a disaster. This creates two incentives that are at odds with the public interest – an incentive to delay the declaration of a disaster (to start the clock) and an incentive to recommence operations before an issue is completely resolved in order to remain compliant with the rule. These risks taken together along with the reality that marketplaces are incentivized naturally to stay open for trading should support a change from a prescribed recovery period to a best efforts standard.

We also request more clarity on what qualifies as a disaster and how the CSA interprets when a service such as trading is deemed to not be operative. Does this mean that a problem with a critical service impacts all participants or a single or group of participants? System issues do not always impact all participants. Given different servers used by different customers an issue may only affect a small number of participants.

We recommend that the proposed 2 hour mandated recovery time for marketplaces (and IIROC and one hour recovery time for the Information Processor) be moved to a best efforts standard. Since there is no way to ensure that systems recover within an exact time and a predictable time frame, mandating a recovery time we believe introduces greater risk than otherwise exists today.

Regulatory redundancy with IIROC rules – We support the requirement for marketplaces to create and test effective BCPs. We note however that the BCP requirements in the Proposed Amendments are already applicable for an ATS under IIROC Dealer Member Rule 17.16 and the BCP Adequacy Checklist published by IIROC in 2006. According to these guidelines the CEO of each ATS must annually certify the following:

- That a BCP has been created in accordance to prudent business practice and that it is has been tested annually (including the date of testing);

- The date of the latest BCP update;
- The date the BCP was approved by Senior Management;
- That procedures are in place for failover business processes and notify clients who to contact in the case of a significant business disruption;
- An individual has been assigned responsibility for the plan.

We note this as an example of the regulatory differences that apply to ATSS and exchanges created by the registration requirement for ATSS to be investment dealers. In order to ensure a consistent approach is taken to both types of marketplaces we reiterate our position that this registration requirement be removed.

(ii) *Uniform test symbols in production environments*

We support the introduction of test symbols for production environments and convening an industry working group to assist in identifying issues related to their implementation. We note that all symbols in a production environment demand system resources and that a marketplace should be able exercise its power under Part 4 of National Instrument 23-103 to suspend access to a test symbol in a production environment if it negatively impacting the production environment.

(iii) *Expansion of ISR*

Please confirm that the dates for delivery of a marketplace's ISR new requirement for delivery of a marketplace's ISR is the earlier of 30 days after it has been presented to the Board of Directors or Audit Committee or 60 calendar days after December 31st apply only to the delivery date of the report and not the audit period (being calendar year).

(iv) *Launch of new marketplaces and material change to marketplaces technology requirements*

Understanding that material changes to the technology specifications of a marketplace require development work on behalf of vendors and subscribers, we believe that marketplace changes should be accompanied with a reasonable period for development to take place before the change being implemented. However, given the interest of stakeholders to not add to their IT agendas we would like to understand how the determination of a "reasonable period needed for development to take place" will be made? The current 3 month implementation requirement today already ensures time for stakeholders to prepare for a change.

II. Use of marketplace participants' trading information for research

A benefit of electronic trading is the plethora of historic trading data recorded that can be analyzed to more objectively study the impact of new regulations, commercial innovations or changing macro-economic conditions. We understand the value that this information holds – for a commercial interest or for public policy formation and support the Proposed Amendments that will permit an independent third party to be granted access to trading information under certain conditions. We are concerned however about the potential harm that the misuse of this information represents. Consequently, we recommend in addition to the pre-conditions set out in Proposed Amendments that must be met by an capital markets researcher and a marketplace that an addition control be introduced before trading information is shared –

approval secured by the CSA as part of a request process. This process would simply be an oversight function ensuring that all requirements have been met before trading information is released. This will ensure that marketplaces receive appropriate regulatory permission prior to providing private customer trading information to a third party and in turn will protect against conflicts and prove to safeguard against the impact of a breach.

III. Co-location and other access arrangements with a service provider

While co-location and connectivity services are often grouped together, they are separate and distinct from one another. Co-location services are provided by a hosting facility to store computer systems in a cool and dry environment sufficiently supplied with power. Connectivity services cover the permission to connect directly to a marketplace matching engine. This difference is evidenced in the fact that only the customer has the legal right to enter a cabinet at a hosting facility. If a customer of a hosting facility wanted to connect to our matching engine they could only do so with permission from the marketplace. In the case of Chi-X Canada, only Chi-X Canada designated staff or persons authorized by Chi-X Canada are permitted to add or remove any connections into our matching engine.

The ability to ensure that a vendor acts in accordance with any policy or direction outside of its legal agreement with its customer is difficult to ensure at best. Influence can be effective if the vendor is an affiliate of the marketplace but impossible to ensure otherwise. Instead, best efforts are all that can be shown by performing proper due diligence when selecting a service provider including enquiring about its policies and procedures that may include access requirements. Changes will be more difficult if a service agreement is already in place. In addition, proper monitoring and oversight must be performed to continue to be abreast of developments from a provider.

Consequently, it is impossible (other than agreeing to include fair access requirements into a contractual agreement) to ensure that fair access requirements exist and are practiced. We also note that access requirements are different than available capacity. A hosting facility may grant access fairly and equally but may not have adequate space to offer services to everyone.

For these reasons we recommend that proper due diligence be the expectation placed on a marketplace for ensuring that a third party provider follows its fair access policies. In addition, in order to not disrupt the trading activities of those participants hosted, contingencies should be acknowledged as acceptable practice. Time should be given to have a marketplace find a different provider should it fail to act fairly, run out of capacity or other issues arise. We note however, that it is in the commercial interest of hosting centers to act fairly to ensure the viability of their model.

IV. Information in Forms 21-101F1, 21-101F2 and 21-101F3

(i) Guidance regarding significant changes to Form 21-10F1 and Form 21-101F2

When the ATS Rules were first introduced, ATSs were granted certain advantages over exchanges when making significant changes in order to foster and encourage competition. Over time these advantages were removed as regulation was harmonized for both types of marketplaces. During this period, the protocol for making changes to either Form 21-101F1 or Form 21-101F2 essentially became identical. In addition, with the rise of competition new innovation driving regulation emerged. This led to an approval process that has become “process heavy” and highly prescriptive for making changes and in turn has demanded more resources and led to longer approval times.

We recognize the Proposed Amendments as moving from this approach toward taking a more principles based approach to regulation for marketplace changes and agree with this approach. Given the growth and maturation of the equity market and the increased knowledge and expertise of its regulators, we believe this is the right time to shift more toward principles based regulation for the approval process in order to better facilitate changes in operation and bringing new services to the street.

Proposed Amendments introduce a new standard to determine whether or not certain changes are significant. As outlined in the notice, whereas today items listed from (d) to (n) in Part 6.1 of 21-101CP would be deemed significant and trigger the 45 day requirement, Proposed Amendments propose to leave the marketplace with the responsibility to determine whether or not an item is significant by deciding if an issue significantly impacts a marketplace, its systems, market structure, marketplace participants or their systems, investors, issuers or the Canadian capital markets. Permitting marketplaces discretion when determining whether or not certain changes are significant will help operations be more fluid and remedy some unnecessary delays.

This being said, given the introduction of this new test for significance we would encourage the CSA to be mindful about ensuring transparency while the interpretation of this standard evolves over time. In the past there have been times when one marketplace interprets a change as significant while another does not. In order to ensure the process treats all marketplaces fairly it would be helpful for Staff to communicate to the marketplaces when a decision is made regarding what it considers to be significant. This can be done either informally with a phone call or formally through published guidance.

(ii) Annual Certification of Form 21-101F1 and Form 21-101F2

Proposed subsection 3.2(4) will require a marketplace CEO to annually certify that the information in a marketplace's form is true, correct and complete and that it reflects the operation of the marketplace as they have been implemented. In addition to this proposed requirement, a marketplace will also need to provide an updated and consolidated form.

We can understand the value of annual CEO certification but do not see the need for a complete and new consolidated form being submitted each year at the same time. A comprehensive vetting of all items of the Form would accompany the process of CEO certification. In addition, given the very detailed rule protocol that exists for changes to be made to the applicable form, we question the need for resources to be spent preparing and providing a consolidated form. We recommend that either CEO certification is introduced or that a consolidated form be required with a preference to CEO certification only. Although the tendency exists for regulators to have more information than is necessary at their disposal, the resources (both marketplace and commission staff) to provide and review this information should not be overlooked.

We would like to thank the CSA for the opportunity to respond to the Proposed Amendments and welcome the opportunity to discuss our submission with the staffs.

Sincerely,

Chi-X Canada