



2021

# Market Structures Oversight Framework

# TABLE OF CONTENTS

- INTRODUCTION..... 3**
  
- PRINCIPAL REGULATED MARKET STRUCTURES ..... 4**
  
- GUIDING PRINCIPLES..... 6**
  
- OVERSIGHT FRAMEWORK OVERVIEW ..... 7**
  - Phase A Risk profile ..... 8**
    - Step 1 – Identify core activities, activities of interest and inherent risks ..... 9
    - Step 2 – Assess inherent risks of core activities and activities of interest ..... 9
    - Step 3 – Assess operational management and quality of the control functions..... 10
    - Step 4 – Assess net risk and adjusted net risk of a core activity and activity of interest ..... 11
    - Step 5 – Analyze financial viability ..... 11
    - Step 6 – Determine the risk profile ..... 11
  - Phase B Oversight program ..... 12**
  - Phase C Oversight activities ..... 12**
    - Step 1 – Collect and analyze information ..... 12
    - Step 2 – Communicate the results of the oversight review ..... 13
    - Step 3 – Follow up on the action plan stemming from the oversight review report findings . 15
  
- APPENDIX 1 RISK CATEGORIES ..... 16**

Legal Deposit – Bibliothèque et Archives nationales du Québec, 2021  
ISBN 978-2-550-88378-4 (PDF)



## INTRODUCTION

The Autorité des marchés financiers (the “AMF” or the “Authority”) is the body mandated by the Québec government to regulate Québec's financial markets and assist consumers of financial products and services, particularly in the areas of insurance, securities, derivatives, deposit institutions – other than banks – the distribution of financial products and services, and mortgage brokerage.

As provided for under its constituting Act,<sup>1</sup> part of the AMF's mission is to:

*“Supervise stock market and clearing house activities and monitor the securities market, in particular, by administering the controls provided by law as regards access to the public capital market, ensuring that the issuers and other practitioners involved in the financial sector comply with the obligations imposed on them by law and taking any measure provided by law for those purposes;” and*

*“Supervise derivatives markets, including derivatives exchanges and clearing houses and ensure that regulated entities and other derivatives market practitioners comply with the obligations imposed by law.”*

The AMF, through the Surintendance des marchés de valeurs supervises the securities and derivatives markets in Québec by, among other things, ensuring compliance with applicable laws and regulations.

Specifically, the AMF oversees the activities of exchanges and markets, clearing houses, self-regulatory organizations (SROs),<sup>2</sup> contingency funds, and other entities that it has recognized, designated, authorized or exempted for the purpose of carrying on securities or derivatives activities in Québec.<sup>3</sup>

To accomplish this, the AMF conducts ongoing monitoring of these market structures, including regularly inspecting their operations and reviewing their rules and rule changes. Usually, this work is carried out with the AMF's Canadian Securities Administrators partners and, in some cases, the Bank of Canada.

This framework describes the AMF's approach to market structures oversight.

The oversight approach set out in this framework is guided by the principles and guidance published by various international bodies<sup>4</sup> for regulatory and oversight agencies. The AMF plays an active role within the key domestic and international regulators' forums on best oversight practices, enabling it, among other things, to update and maintain its oversight approach.

<sup>1</sup> Act respecting the regulation of the financial sector, CQLR, c. E-6.1.

<sup>2</sup> Except the Chambre de la sécurité financière and the Chambre de l'assurance de dommages.

<sup>3</sup> See the Principal Regulated Market Structures table on page 4.

<sup>4</sup> Financial Stability Board, Basel Committee on Banking Supervision, Committee on Payments and Market Infrastructures, International Organization of Securities Commissions.

# PRINCIPAL REGULATED MARKET STRUCTURES

<p><b>Alternative trading system</b></p>	<p>Constitutes, maintains or provides a market or facility that brings together buyers and sellers of securities, brings together the orders for securities of multiple buyers and sellers and uses established, non-discretionary methods under which the orders interact with each other and the buyers and sellers entering the orders agree to the terms of a trade. It does not require an issuer to enter into an agreement to have its securities traded on the marketplace, does not provide, directly or through one or more subscribers, a guarantee of a two-sided market for a security on a continuous or reasonably continuous basis, does not set requirements governing the conduct of subscribers, other than conduct in respect of the trading of those subscribers on the marketplace, and does not discipline its members other than by exclusion from participation in the marketplace.</p>
<p><b>Clearing house</b></p>	<p>Is responsible for clearing and settling securities transactions and acts as the central counterparty for trades executed between market participants.</p> <p><b>Central counterparty</b></p> <p>Interposes itself between the counterparties to securities or derivatives transactions in one or more financial markets, acting functionally as the buyer to every seller and the seller to every buyer or the counterparty to every party.</p> <p><b>Central securities depository</b></p> <p>Provides centralized facilities as a depository of securities, including securities accounts, central safekeeping services, and asset services, which may include the administration of corporate actions and redemptions.</p> <p><b>Securities settlement system</b></p> <p>Enables securities to be transferred and settled by book entry according to a set of predetermined multilateral rules.</p>
<p><b>Contingency fund</b></p>	<p>Administers and manages a fund to protect, subject to certain limits, eligible investors who have suffered financial harm.</p>
<p><b>Exchange</b></p>	<p>Constitutes, maintains or provides a market or facility that brings together buyers and sellers of securities, brings together the orders for securities of multiple buyers and sellers and uses established, non-discretionary methods under which the orders interact with each other and the buyers and sellers entering the orders agree to the terms of a trade. It provides both a listing function and, directly, or through one or more marketplace participants, a guarantee of a two-sided market for a security on a continuous or reasonably continuous basis, sets the requirements governing the conduct of marketplace participants and disciplines marketplace participants.</p>

<b>Information processor</b>	Provides collection, processing, distribution and publication of information for orders for, and trades in, exchange-traded securities.
<b>Matching service utility</b>	Provides centralized facilities for the comparison of trade data respecting the terms of settlement of a trade or transaction (other than a clearing house).
<b>Rating organization</b>	Issues a rating, i.e., an assessment, disclosed publicly or distributed by subscription, of the credit quality of an issuer as an entity or with respect to specific securities or a specific portfolio of securities or assets.
<b>Self-regulatory organization (SRO)<sup>5</sup></b>	Monitors or supervises the conduct of its members or participants as regards the carrying on of an activity governed by securities or derivatives legislation.
<b>Trade repository</b>	Centrally collects and maintains over-the-counter derivatives data.

## SCOPE

The framework applies to market structures<sup>6</sup> governed by one of the following statutes:

- *Act respecting the regulation of the financial sector*, CQLR, c. E-6.1
- *Securities Act*, CQLR, c. V-1.1
- *Derivatives Act*, CQLR, c. I-14.01

The market structures concerned may also be governed by several regulations, including:

- Regulation 21-101 respecting Marketplace Operation, CQLR, c. V-1.1, r. 5
- Regulation 23-101 respecting Trading Rules, CQLR, c. V-1.1, r. 6
- Regulation 23-103 respecting Electronic Trading and Direct Electronic Access to Marketplaces, CQLR, c. V-1.1, r. 7.1
- Regulation 24-102 respecting Clearing Agency Requirements, CQLR, c. V-1.1, r. 8.01
- Regulation 91-507 respecting Trade Repositories and Derivatives Data Reporting, CQLR, c. I-14.01, r. 1.1

The manner in which the AMF implements these regulations is explained in the related policy statements.

In general, a market structure may operate in Québec only if it is recognized or exempt from recognition by the AMF or has been designated or otherwise authorized to operate in Québec under the law to which it is subject. The AMF may, on the conditions it determines, recognize, designate, authorize or exempt a market structure.

## UPDATING

The framework is updated periodically based on developments in the financial sector, best oversight practices and regulations, emerging trends, and risks identified as a result of oversight activities.

<sup>5</sup> Except the *Chambre de la sécurité financière* and the *Chambre de l'assurance de dommages*.

<sup>6</sup> Except the *Chambre de la sécurité financière* and the *Chambre de l'assurance de dommages*.

## GUIDING PRINCIPLES

The following principles underpin the oversight approach.

### PREVENTION

The AMF applies monitoring that enables early risk identification and management with a view to quickly detecting issues and intervening with market structures in a timely manner.

### SCALABILITY

The AMF scales its oversight activities to the nature, scope and frequency of the work involved and to the resources to be allocated based on its assessment of the market structure's risk profile and systemic importance (if applicable).

### DIFFERENTIATION

In order to assess risk, the AMF differentiates between the risks inherent to the activities undertaken by the market structure and the market structure's control functions at both the operational and oversight levels. This differentiation is crucial to establishing expectations for the management of risk and to determining appropriate corrective actions, when needed.

### ACCOUNTABILITY

The AMF assesses the quality and robustness of the lines of defence, senior management and the governance bodies established by the market structure.

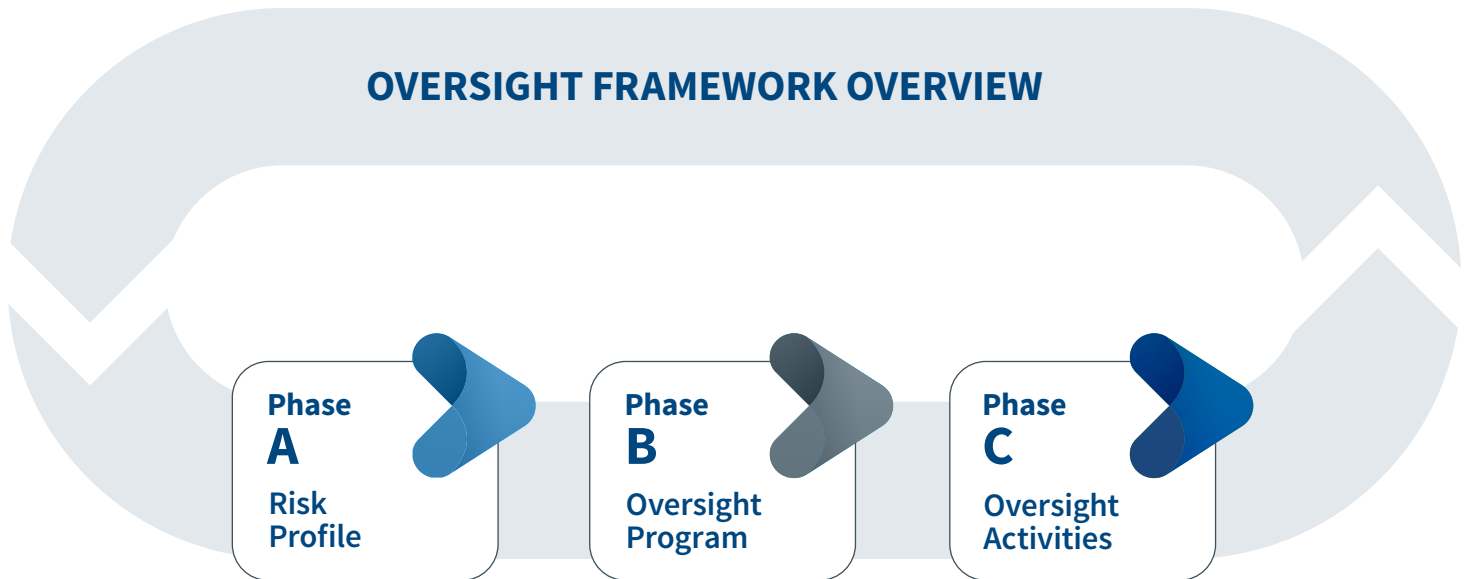
### COMPLEMENTARITY

The AMF relies on the work of third parties, such as the market structure's internal or external auditors and other regulators and oversight bodies if the independence, scope and quality of their work is deemed adequate.

### INTERACTIVITY

The market structure and the AMF maintain an open, two-way communication, with the AMF informing the market structure of regulatory and oversight developments on a timely basis and the market structure promptly advising the AMF of any new initiatives or developments that could affect its risk profile. For a systemically important market structure, communications between the AMF, senior management and governance bodies may be intensified.

## OVERSIGHT FRAMEWORK OVERVIEW



The AMF carries out risk-based oversight according to the three phases shown in the above diagram.

### PHASES OF THE OVERSIGHT FRAMEWORK

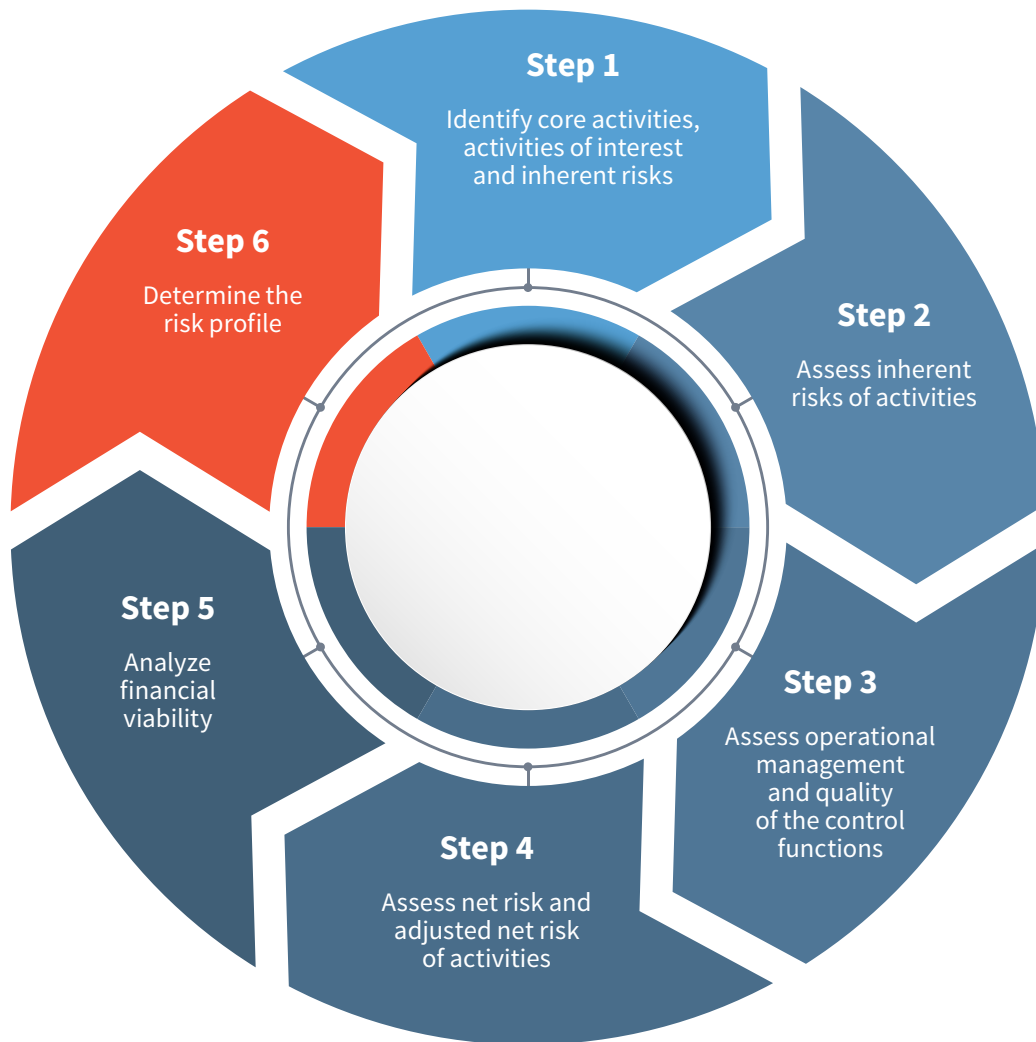
This section describes the methodology supporting the oversight approach. This methodology is tailored to the nature, size and complexity of a market structure's activities and applied on an ongoing basis to determine and document each market structure's risk profile and the oversight approach to be used.



## Phase A Risk profile

A risk profile is a rating of a market structure's overall risk level. It is arrived at by assessing the risks inherent to the market structure's core activities and activities of interest, the quality of its control functions and, if applicable, its financial condition.

A risk profile is dynamic because it is updated to reflect changes in the risks to which the market structure is exposed and the results of oversight activities. It is used by the AMF for internal purposes and may be shared with other regulators. The risk profile and documentation supporting it are subject to the AMF's *Politique sur la protection et la sécurité de l'information* (policy on information protection and security).<sup>7</sup>



<sup>7</sup> As a public body, the AMF is also governed by the *Act respecting access to documents held by public bodies and the protection of personal information*, CQLR, c. A-2.1.



### **Step 1 – Identify core activities, activities of interest and inherent risks**

The first step in the approach is to identify the core activities specific to each market structure. A core activity is generally a critical activity or a key business process that enables the market structure to carry out its mission.

An activity of interest is a particular project, business development, process, policy or direction within a core activity that, in itself, could have a significant impact on the market structure's risk profile.

These activities are identified using multiple sources of information, including the information submitted in support of the market structure's application for recognition, designation, authorization or exemption, i.e., the description of its activities and its operating rules, as well as the memorandums of understanding (MOUs), financial reports and strategic plans.

The criteria used to determine whether an activity can be considered a core activity or an activity of interest for the market structure may include:

- the importance of the activity in carrying out its mission
- the impact of the activity on its role in maintaining market integrity and efficiency and upholding the public interest
- the potential impact on its financial viability
- the impact that an interruption in the activity would have on the continuity of its business and on market efficiency

The inherent risks of each core activity and activity of interest are identified at this point.

### **Step 2 – Assess inherent risks of core activities and activities of interest**

The second step is to assess the risks inherent to the nature and characteristics of each core activity and activity of interest. An activity's inherent risk is the probability of a failure occurring and its potential impact on the execution of the market structure's strategy or mission, without taking controls into account.

Generally, the following categories of inherent risks are assessed:

- resources risk
- operational risk
- legal risk
- business and strategic risk

These risk categories are described in Appendix 1.

#### **Assessing inherent risks**

The degree to which the core activities and activities of interest are exposed to these inherent risks is determined by considering a number of qualitative and quantitative factors specific to each risk. Those factors include: the general organization of the market structure (legal basis and governance), the contextual and industry environment, systemic importance, and the nature and complexity of the products and services offered. This assessment requires a good knowledge of the market structure's activities and of the potential impacts and probabilities of occurrence.

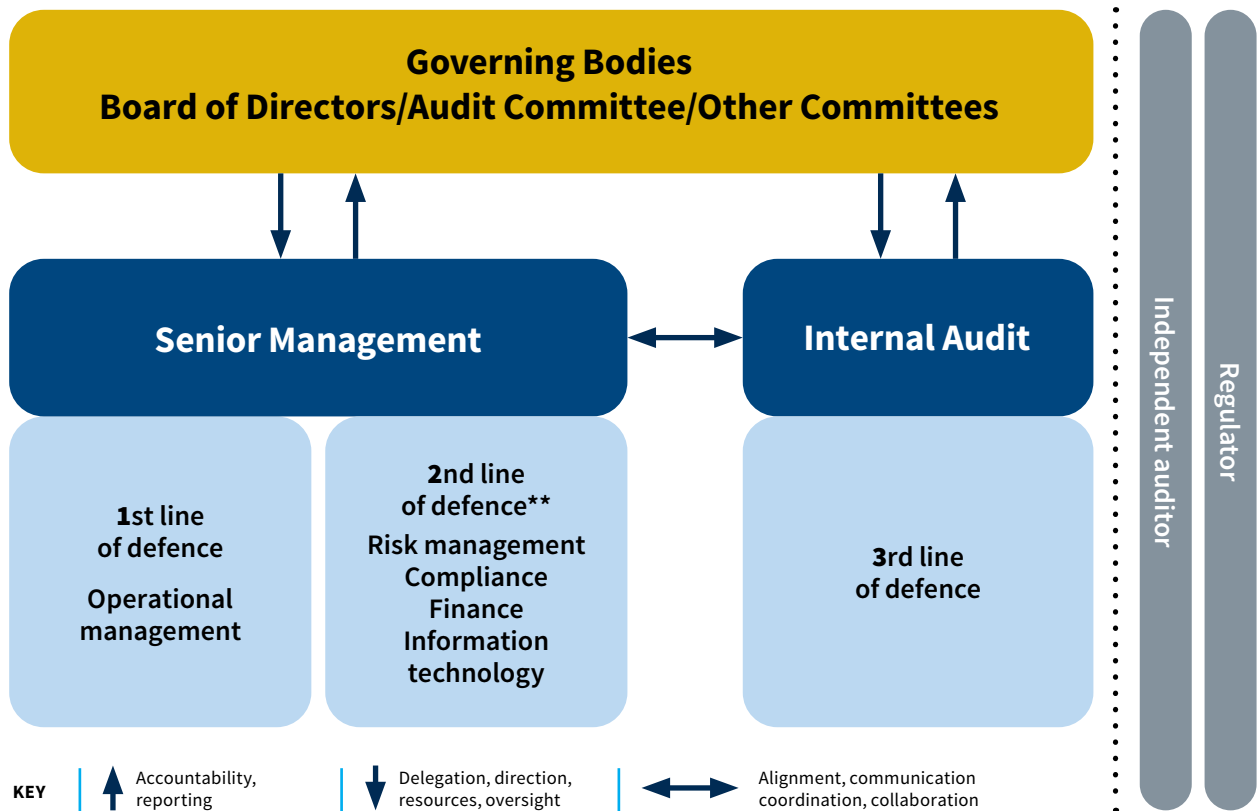
The risk inherent to each core activity and activity of interest depends on its impact and the probability of its occurring. The risk is assessed as "high," "moderate-high," "moderate-low," or "low."

### Step 3 – Assess operational management and quality of the control functions

The AMF assesses the quality of the control functions to determine the extent to which the previously identified inherent risks are mitigated. The quality of a market structure’s risk management is assessed based on the effectiveness of the lines of defence, including the control functions, senior management and governance bodies.

The scope of the oversight activities for operational management related to a core activity or an activity of interest may be adjusted based on the effectiveness of the control functions comprising the second and third lines of defence, senior management and the governance bodies. The assessment of the quality and effectiveness of these control functions is based, in particular, on compliance with legal, regulatory and normative provisions, and then on the results of oversight review activities and the work of third parties, if applicable.

## THREE LINES MODEL OF GOVERNANCE\*



\* Adapted from IIA’s Three Lines Model, The Institute of Internal Auditors, July 2020

\*\* The individuals in charge of the 2nd line of defence are integral members of senior management.

For each core activity and activity of interest, the quality of the risk management controls is assessed as “strong,” “moderate-high,” “moderate-low” or “weak.” The factors considered in the assessment include:

- implementation of a strong risk management culture in which expectations are clearly communicated by senior management and the board of directors and responsibilities are defined for employees
- whether senior management has identified, assessed, quantified, controlled, mitigated and monitored inherent risks, based on the market structure’s systemic importance, where applicable
- the ability of senior management to identify and control new risks as they arise, taking into account, in particular, the market structure’s strategic plan
- the implementation of appropriate policies and procedures
- whether management information systems and other forms of communication are commensurate with activity complexity

#### **Step 4 – Assess net risk and adjusted net risk of a core activity and activity of interest**

The net risk of an activity is the activity’s inherent risk (Step 2) after mitigation by the quality of operational management and the control functions (Step 3) and is rated “high,” “above average,” “moderate” or “low.”

Adjusted net risk is the activity’s net risk adjusted for other, not previously considered contextual or industry factors.

#### **Step 5 – Analyze financial viability**

A market structure must maintain sufficient resources to sustain its mission and current and future operations and contribute to its long-term viability. In particular, a systemically important market structure must hold liquid net assets funded by equity in line with certain required thresholds.

#### **Step 6 – Determine the risk profile**

After the core activities, activities of interest and inherent risks have been identified (Step 1), such risks and the quality of operational management and the control functions have been assessed (Steps 2 and 3, respectively), and the adjusted net risk of each core activity and activity of interest has been established (Step 4), the AMF carries out Steps 5 and 6 to determine the market structure’s risk profile.



## Phase B Oversight program

The AMF develops an oversight program based on each market structure's risk profile, taking into account the size, nature and complexity of the market structure's activities and, where applicable, systemic importance. The oversight program, which also takes into consideration the orientations and priorities of the AMF, determines the nature, scope and frequency of oversight.

The oversight program is updated at least once a year. It may be modified at any time when the AMF becomes aware of an event that could have an impact on the market structure's risk profile. For instance, a management practice or new activity which could have a significant impact on market participants would cause the risk profile to be updated; appropriate oversight activities might then be performed. Moreover, the oversight program includes an analysis of the documents filed in accordance with the requirements set out in the regulations and in the recognition, designation, authorization or exemption orders.

### **Relationships with the market structures**

Oversight of each market structure is conducted jointly with other regulators and, in some cases, the Bank of Canada. This joint effort is guided by the MOUs governing oversight of the regulated entities to which the MOUs apply. The AMF and the other regulators are responsible for coordinating communications with the market structures. The AMF establishes and maintains relationships with a market structure's senior management and internal and external auditors for this purpose.



## Phase C Oversight activities

Phase C results from the activities required to establish the market structure's risk profile (Phase A) and from the development of the oversight program (Phase B). The purpose of the oversight activities is to verify the extent to which the market structure is compliant with the provisions of laws and regulations, the terms and conditions of the recognition, designation, authorization or exemption orders and other AMF orders, and how the market structure is performing its functions and exercising its powers.

MOUs between the AMF, the Canadian Securities Administrators and, in some cases, the Bank of Canada are in place to ensure effective oversight in Québec and the other Canadian provinces. Oversight programs, including periodic oversight reviews, are an integral part of the MOUs.

### **Step 1 – Collect and analyze information**

The collection and analysis of information is an integral part of the AMF's oversight activities and help maintain and even enhance knowledge of the market structure's activities and sector.

In addition, the AMF must assess the extent to which it can rely on the work of the market structure's internal and external auditors and home regulator, as applicable.

## Oversight activities

The scope of oversight activities depends on the market structure's risk profile, its systemic importance, and the oversight program. These activities and interactions with individuals performing functions relating to the market structure's lines of defence, senior management and governance bodies provide further insight into the workings of the market structure.

Oversight activities include qualitative and quantitative analyses of the information collected in accordance with laws, regulations and the AMF's orders, as well as regular communications with the market structure. Within the scope of its activities, the AMF is authorized by law to request any information and documents required to conduct a more in-dept examination of the market structure's activities, including through correspondence, questionnaires and self-assessment forms.

An oversight review is a key component of oversight. The market structure is sent advance written notice of the scheduled start date and scope of the oversight review as well as the required information and documents. The market structure appoints a resource person to coordinate oversight review activities.

## Step 2 – Communicate the results of the oversight review

The AMF provides the market structure with the results of its oversight review, which are presented in an oversight review report. The report contains the review findings regarding key activities and/or processes requiring corrective action.

The oversight review report includes sections on the risks or issues addressed by the oversight review; findings, expectations and observations; and, depending on the case, appendices setting out the methodology used, the scope of the review and the "priority of findings" scale.

Before the oversight review report is provided to the market structure, the findings are first discussed with the market structure's senior management. The items discussed are considered in drafting the final report, particularly if they serve to clarify the findings that are presented. The oversight review report is sent to the market structure's chief executive officer.

### Priority of findings

Findings are prioritized into "high," "medium" or "low" based on the degree of urgency of the corrective actions expected to be taken regarding:

- identified deficiencies with respect to the implementation and application of policies and procedures
- repeated non-compliance with internal and external rules governing the market structure, particularly the terms and conditions of the recognition, designation, authorization or exemption orders or other AMF orders applicable to it
- deficient internal controls
- inappropriate management practices
- weaknesses identified when assessing the control functions comprising the lines of defence, senior management and the governance bodies
- financial condition deemed to be of concern

A "repeat finding" is a previously identified finding that was not satisfactorily resolved by the market structure.

The priority levels of findings are:

Priority	Description
High	The AMF identifies an issue that, if unresolved, will result in the market structure not meeting its mandate, or one or more of the terms and conditions of the recognition, designation or authorization order, or other applicable regulatory requirements. The market structure must immediately put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to the AMF. If necessary, compensating controls should be implemented before the finding is resolved. The market structure must regularly report on its progress.
Medium	The AMF identifies an issue that, if unresolved, has the potential to result in an inconsistency with the market structure's mandate, or with one or more of the terms and conditions of its recognition, designation or authorization order, or with other applicable regulatory requirements. The market structure must put in place an action plan (with any supporting documentation) and timelines for addressing the finding that are acceptable to the AMF. If necessary, compensating controls should be implemented before the finding is resolved. The market structure must regularly report on its progress.
Low	The AMF identifies an issue requiring improvement in the market structure's processes or controls and raises the issue for resolution by the market structure's management.
Repeat finding	A finding that was previously identified by the AMF and not resolved by the market structure will be categorized as a repeat finding in the oversight review report and may require that the level of priority be raised from the initial level in the previous oversight review report.

### **Resolution of AMF findings**

Within 30 days following receipt of the final oversight review report, the market structure must submit an action plan that includes timelines for addressing the finding and/or a description of the corrective actions that it has already taken. If necessary, the market structure must implement compensating controls until the finding is appropriately resolved. In some circumstances, the action plan must be prepared by a representative of the market structure's senior management, then approved by the board of directors or a board committee. Depending on the significance of the findings and/or the response provided, a shorter timeline or corrective actions in addition to or different from those presented in the action plan may be required.

### **Step 3 – Follow up on the action plan stemming from the oversight review report findings**

The AMF follows up on the market structure's progress in implementing its action plan to resolve the findings set out in the oversight review report. This follow-up is part of an ongoing process and is performed to ensure that actions taken based on the findings are coherent and adequate and are implemented according to the timelines specified in the action plan. Any changes that affect the corrective actions or timelines must be communicated to the AMF.

### **Additional measures under applicable legislation**

If the AMF considers a corrective action proposed or taken by a market structure to be inadequate, or if the market structure repeatedly fails to resolve the findings or does not meet the specified timelines, the AMF will be able to take any of the measures provided in the applicable legislation.

## APPENDIX 1

### RISK CATEGORIES

The following definitions illustrate some of the most common risk concepts. This is not an exhaustive list of the risks monitored by the AMF or to which market structures are exposed. These risks can represent a reputational risk for a market structure.

A market structure may be designated as systemically important due to the critical role it plays in the Canadian financial system. Managing such risks helps this market structure control systemic risk, i.e., the risk of disruptions spreading across the financial system.

#### Resources risk

The risk that a market structure will not have sufficient, or any, resources available, when needed, to fulfill its mission and obligations.

This risk includes:

- Financial risk
  - Market risk
  - Credit risk
  - Liquidity risk
  - Custody and investment risk
- Technology risk
- Human resources risk

#### Operational risk

The risk resulting from inadequate or failed internal processes, people, systems, or from external events.

This risk includes:

- Process risk
- Human resources risk
- Information and communication technology risk
- Outsourcing risk
- External risk

#### Legal risk

The risk arising from a failure to comply with, or from the unexpected application of, a legal, regulatory or contractual obligation and the risk arising from any legal proceedings.

This risk includes:

- Risk of legal proceedings
- Risk related to the implementation of an unexpected legal, regulatory or contractual obligation
- Risk related to non-compliance with legislation or the terms and conditions of recognition, designation, authorization or exemption orders

#### Business and strategic risk

The risk arising from a market structure's inability to implement appropriate business plans, strategies, decision-making processes and allocation methods adapted to changes in contextual factors and in its industry environment.

This risk includes:

- Business risk
  - Economic
  - Competition
  - Political
  - Socio-demographic
- Strategic risk
  - Planning
  - Execution
  - Strategic choice
  - Adaptation to technological innovation