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<input type="checkbox"/>	Trading – Equity and Index Derivatives	<input checked="" type="checkbox"/>	Technology
<input checked="" type="checkbox"/>	Back-office – Futures	<input checked="" type="checkbox"/>	Regulation

**CIRCULAR**  
**January 16, 2013**

**ELECTRONIC TRADING RULES  
AND  
CANADIAN SECURITIES REGULATORS REGULATION 23-103  
AND  
ITS COMPANION POLICY**

On June 28, 2012, the Canadian Securities Administrators (the CSA) published the *Electronic Trading Rules* (referred hereafter as Regulation 23-103 or the ETR) and its *Companion Policy*, copies of which are attached to this Circular. Regulation 23-103 and its Companion Policy will become effective on March 1, 2013<sup>1</sup>. The CSA also published, on December 20, 2012, a *Frequently Asked Questions* document about this new Regulation, copy of which is also attached to this circular.

The ETR introduce a comprehensive framework designed to address areas of concern and risks brought about by electronic trading. Such risks include those relating to liability, credit, market integrity, sub-delegation, technology or systems and regulatory arbitrage.

Bourse de Montréal Inc. (the Bourse) intends to align its Rules with the requirements set out in the ETR and to introduce new provisions detailing the responsibilities of approved participants with respect to the supervision of electronic trading. Pending the publication of such regulatory amendments proposal, the Bourse requires that all its approved participants ensure that they will be in compliance with the ETR when it comes into force next March 1, 2013.

The purpose of this circular is to outline the expectations of the Bourse and to clarify some issues that have been raised by some approved participants.

The ETR apply to all orders sent electronically to the Bourse’s market whether generated by an automated order system or not. In other words, Regulation 23-103 also applies to orders manually handled by an approved participant but sent electronically to the Bourse.

<sup>1</sup> On December 7, 2012, some CSA members, including the Quebec Autorité des marchés financiers who is the lead regulator of Bourse de Montréal Inc., issued Multilateral CSA Staff Notice 23-313 *Blanket Orders Exempting Marketplace Participants from Certain Provisions of Regulation 23-103 respecting Electronic Trading* regarding the testing and implementation of the automated pre-trade risk controls required under subparagraph 3(3)(a) of the Regulation. Subparagraph 3(3)(a) requires that a marketplace participant’s risk management and supervisory controls, policies and procedures be reasonably designed to systematically limit the financial exposure of the marketplace participant, including, for greater certainty, preventing:

- (i) the entry of one or more orders that would result in exceeding pre-determined credit or capital thresholds for the marketplace participant and, if applicable, its client with marketplace access provided by the marketplace participant, and
- (ii) the entry of one or more orders that exceed pre-determined price or size parameters.

The *Blanket Orders* provides temporary relief from subparagraph 3(3)(a) of Regulation 23-103 if a marketplace participant is testing the automated pre-trade risk controls required under paragraph 3(3)(a) of the Regulation by March 1, 2013. The *Orders* grant relief until May 31, 2013. It is important to insist upon the fact that to benefit from the relief, marketplace participants **must have started testing** the automated pre-trade risk controls required under subparagraph 3(3)(a) of the Regulation **by March 1, 2013**. All other requirements under Regulation 23-103 must be fully implemented by March 1, 2013.

Approved participants are therefore expected to establish risk policies, procedures and controls that cover not only automatically transmitted orders but also manual orders that are subsequently transmitted electronically. Furthermore, ETR apply not only to clients' orders but also to orders for firm and professional accounts.

The determination of whether or not the ETR are applicable is not based on the registration status and/or location of an approved participant but on the marketplace where orders are transmitted. Since it has been determined by the regulators that the Bourse's market is a market that is subject to the application of the ETR, all approved participants of the Bourse, **including foreign approved participants**, are required to comply with the ETR requirements.

Compliance with the Canadian ETR by foreign approved participants should not cause any significant problem since the CSA, prior to the drafting of these ETR, closely reviewed a number of international initiatives on this subject matter such as the U.S. Securities & Exchange Commission Rule 15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access*, adopted in November 2010, the final report prepared by the International Organization of Securities Commissions' (IOSCO) Standing Committee, *Principles for Direct Electronic Access to Markets* published in August 2010, the Australian Securities and Investments Commission (ASIC) consultation Paper 145: *Australian Equity Market Structure: Proposals*, and the European Commission *Review of the Markets in Financial Instruments Directive (MiFID)* published in December of 2010. The Canadian ETR are therefore closely aligned with the regulatory requirements that have already been implemented or are expected to be implemented in other jurisdictions.

A noteworthy aspect of the ETR is that they are principles-based and therefore they do not provide detailed guidance or requirements. It is the responsibility of each approved participant to determine what controls, policies and procedures it should put in place based on an assessment of its business model. The Bourse intends to use the same approach and does not intend to impose detailed requirements or to publish detailed guidelines. For example, for credit or capital controls, these may be set based on different criteria, such as per order, per trade, per account, per trading strategies or using a combination of these factors. It is up to the approved participant to determine the best method as to how to set the capital or credit thresholds in order to manage the risks associated with marketplace access or providing clients with access to a marketplace based on the assessment of its business model.

For what regards the Bourse's market, the Regulatory Division of the Bourse (the Division) will have primary responsibility to ensure that the Bourse's Canadian and foreign approved participants comply with the ETR. To this effect, a review of the controls, policies and procedures in place at each approved participant will be made by the Division in the course of its periodic derivatives instruments trading desk reviews and conclusions regarding the adequacy of such controls, policies and procedures, as well as any applicable recommendations, will be communicated to the approved participant that was the subject of such trading desk reviews.

Many questions have also been raised regarding the requirement to use aggregated pre-trade capital limits in cases where a client trades various types of instruments (options, futures contracts, underlying instruments, etc.) or trades through various channels (electronic access, phone, in writing, etc.). To our knowledge, no approved participants currently have systems that have the capability of making such a pre-trade aggregation on a real-time basis.

Therefore, the Bourse considers that until a real-time aggregating solution is developed and implemented it would be acceptable to use a "bucket" approach (e.g.: a futures contract bucket and an equity and ETF options bucket) pursuant to which the approved participant, after having assessed the global financial resources of its client, other relevant factors (e.g.: client history, client knowledge and expertise, nature of trading done, types of instrument traded, etc.) and the financial exposure that this client represents for the approved participant, allocates pre-trade financial limits for each category of instruments traded by the client and/or for each trading channel used by the client.

As outlined in the *Frequently Asked Questions* published by the CSA, the limits allocated to each “*bucket*” do not need to be electronically linked, but do need to consider the total exposure the approved participant faces with respect to its client. It is therefore important that the approved participant ensure, when making such allocations, that the aggregate of the limits allocated to each bucket does not exceed the total financial exposure that the approved participant is ready to accept.

Approved participants are strongly invited to thoroughly review the various documents attached to this circular in order to ensure that they have a complete understanding of these new regulatory requirements.

For any further question or comment, please contact the Regulatory Division of the Bourse at [regmem@m-x.ca](mailto:regmem@m-x.ca).

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