

CSA/CIRO Staff Notice 23-331

*Request for Feedback on December 2022 SEC Market Structure
Proposals and Potential Impact on Canadian Capital Markets*

October 19, 2023

I. Introduction

On December 14, 2022, the United States Securities and Exchange Commission (SEC) published for comment four proposals to significantly change certain fundamental elements of U.S. market structure (SEC Proposed Amendments).¹ The comment period closed on March 31, 2023.

The Canadian Securities Administrators (CSA) and the Canadian Investment Regulatory Organization (CIRO) (together we) have been reviewing the SEC Proposed Amendments and considering their impact on Canadian equity market structure should the SEC adopt any or all of them in any form. We are publishing this notice to solicit views and to seek comment on certain aspects of the SEC Proposed Amendments, with a focus on the potential impacts on Canadian capital markets, including, to the extent it can be estimated, compliance costs, and the potential policy responses. Neither the CSA nor CIRO is proposing any changes to the regulatory framework in Canada at this time. Any proposed changes that may result from this consultation will be published for comment in the normal course.

While it is not certain that any of the SEC Proposed Amendments will be adopted as final rules as proposed or even adopted at all, we are seeking input at this time as the SEC has announced its intention to finalize the Proposed Amendments in April of 2024,² and any response by the CSA or CIRO must follow the normal rule-making process.

Section II of this notice outlines the core components of the SEC Proposed Amendments. Section III focuses on certain elements of the SEC Proposed Amendments that may have implications on Canadian capital markets and ask specific questions on which we would like stakeholder feedback to further inform our analysis of the issues and decide on an appropriate course of action. We also share our preliminary views on whether any changes may be required to the regulatory regime in Canada as a result of the SEC Proposed Amendments.

II. Overview of SEC Proposed Amendments

Below is a brief overview of the key components of the four SEC Proposed Amendments.

Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better

¹Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders published at www.sec.gov/rules/proposed/2022/34-96494.pdf;

Regulation Best Execution published at www.sec.gov/rules/proposed/2022/34-96496.pdf;

Disclosure of Order Execution Information published at: www.sec.gov/rules/proposed/2022/34-96493.pdf;

Order Competition Rule published at www.sec.gov/rules/proposed/2022/34-96495.pdf;

² <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202304&RIN=3235-AN23>

*Priced Orders*³

The SEC proposes to amend certain rules under Regulation NMS⁴ to:

1. adopt variable minimum pricing increments, or tick sizes, for the quoting and trading of National Market System (NMS) securities. This should enable pricing, for quotes and trades, at sub-penny increments as the current minimum pricing increment for quotes of USD 0.01 causes many NMS stocks to be price constrained;
2. reduce the limit on fees that can be charged by a trading center (as defined by the SEC rules) to take into account lower, sub-penny, pricing increments proposed;
3. accelerate the implementation of the odd-lot information and round lot⁵ definitions under the previously-adopted (but not yet implemented) Market Data Infrastructure Rules (**MDI Rules**). This should enhance transparency about better priced round lot and odd lot orders available in the market.

*Regulation Best Execution*⁶

One of the SEC Proposed Amendments relates to best execution and would introduce a best execution regulatory framework through SEC rules, in addition to existing best execution obligations under the rules of the Financial Industry Regulatory Authority Inc. (**FINRA**) and the Municipal Securities Rulemaking Board (**MSRB**).

The proposed SEC best execution standards would apply to all securities, including options, NMS stocks, corporate and municipal bonds, and digital assets that are securities or government securities under federal securities laws. Further, the SEC best execution proposal includes provisions to address potentially conflicted transactions with retail customers, including payment for order flow (**PFOF**) to retail brokers, and require quarterly and annual review processes. The proposed SEC best execution standards would co-exist with FINRA and MSRB standards, and a dealer that would also be subject to the FINRA and/or MSRB rules would need to comply with the strictest standards.

*Disclosure of Order Execution Information*⁷

The SEC proposes to update the disclosure required under Rule 605 of Regulation NMS, which requires “market centers” (as defined) to disclose order execution quality information for NMS securities. The SEC Proposed Amendments would expand the definition of “covered orders” as well as the scope of entities subject to Rule 605. Additionally, the SEC proposes to amend certain reporting categories and information required to be reported under Rule 605.

The purpose of the SEC Proposed Amendment respecting disclosure of order execution information is to: i) modernize and enhance execution reporting in order to better enable investors

³ www.sec.gov/files/34-96494-fact-sheet.pdf.

⁴ 17 C.F.R. §242.600 – 242.614.

⁵ A “round lot” is usually referred to as a “board lot” in Canadian equity markets.

⁶ www.sec.gov/files/34-96496-fact-sheet.pdf.

⁷ www.sec.gov/files/34-96493-fact-sheet.pdf.

to compare and evaluate execution quality among different U.S. trading venues and U.S. broker-dealers; and ii) help promote competition among market centers and broker-dealers.

Order Competition Rule⁸

One of the SEC Proposed Amendments is intended to enhance competition for the execution of tradeable orders of individual investors by requiring certain orders to be exposed to competition in open auctions before being executed internally by a trading venue that restricts order-by-order competition.

In the U.S., a large proportion of retail orders are traded off-exchange by over-the-counter (OTC) market makers, who generally provide PFOF to retail brokers and then execute these orders internally or route them to an exchange. Consequently, other market participants are typically not provided with an opportunity to interact with these retail orders. The SEC Proposed Amendment is intended to promote competition and transparency by requiring most retail orders to first be routed to a qualified auction operated by an “open competition trading center” (as defined by the SEC) prior to being routed back to the OTC market makers, who could then execute the order internally.

III. Request for Stakeholder Feedback

Regulation NMS: Minimum Pricing Increments, Access Fees, and Transparency of Better Priced Orders

i) Variable Minimum Pricing Increments

According to the SEC, many NMS securities are price constrained by the minimum USD 0.01 pricing increment required under SEC Rule 612 and thus are not able to be priced by market forces. More specifically, in the SEC’s view, U.S. data demonstrates that a significant percentage of executions occur in sub-penny increments as a result of midpoint executions and sub-penny price improvement provided by U.S. OTC market makers who internalize retail orders or through retail liquidity programs on U.S. exchanges.

In order to promote fair and orderly markets as well as fair competition and equal regulation between U.S. OTC market makers, exchanges, and alternative trading systems, the SEC is proposing to assign one of four minimum pricing increments, ranging from USD 0.001 to 0.01, for the quoting and trading of NMS securities priced at or above USD 1.00 per share based on the time-weighted average quoted spread on U.S. marketplaces during an evaluation period, with the minimum pricing increment recalculated on a quarterly basis.

In Canada, CIRO’s Universal Market Integrity Rules (UMIR) 6.1 (1) prohibits the entry of orders at a price including a fraction of a cent, other than half-penny increments in respect of orders with a price of less than CAD 0.50.

CIRO analyzed trading in Canadian listed securities from January 1, 2023 to April 30, 2023 (**study**

⁸ www.sec.gov/files/34-96495-fact-sheet.pdf.

period). On average, 140 securities out of 2,944 would be considered tick-constrained and would have smaller trading increments if a similar rule were adopted in Canada. The trading in these securities accounted for 39% of the volume, 16% of the value and 26% of the trades during the study period. An average of 35 out of the 140 tick-constrained securities are inter-listed with U.S. exchanges.

Question 1: If adopted as proposed by the SEC, please provide your views regarding whether Canada should harmonize with an amended SEC rule, including with respect to:

- (a) the methodology used to calculate minimum pricing increments, including, source of data (which marketplaces and what entity should be responsible for calculation) and time periods during which the metrics are calculated,
- (b) securities to which any amended Canadian price increments would apply (e.g., inter-listed securities only or all or some classes of securities, exchange-traded funds and/or other exchange-traded securities),
- (c) treatment of situations where the use of an aligned methodology results in different trading increments between inter-listed securities traded in Canada and the U.S. (i.e., where the time-weighted average quoted spreads in Canada and the U.S. are different for the same security).

Question 2: If Canadian requirements as related to minimum pricing increments are not amended in response to an amended SEC rule as proposed:

- (a) Would marketplace participants send less order flow to Canadian marketplaces in favor of U.S. trading venues?
- (b) Does the difference in value between the Canadian and the American dollars matter in your analysis?

Question 3: Concerns have been raised in relation to:

- (a) operational resiliency and systems readiness should the number of pricing increments be increased, especially where they would be periodically adjusted on a per-security basis, and
- (b) increase in message traffic (i.e., electronic order and trade messages) that will result from an increase in the number of pricing increments.

Please discuss whether you share these concerns.

Question 4: It has been suggested that any Canadian proposal to amend minimum pricing increments would introduce complexity in managing orders. Please provide your views in this regard, including as related to:

- (a) complexities associated with the frequency at which minimum trading increments could change,
- (b) the necessary lead-time between establishment and implementation of new minimum trading increments both initially and on an ongoing basis,

- (c) challenges with management of existing orders entered on marketplaces at prices that have become invalid trading increments (may be particularly relevant for orders of retail investors that are entered with longer expiry dates (i.e., “GTC” orders)),
- (d) investor education challenges associated with an amended approach to minimum pricing increments.

Question 5: As modifying trading increments in Canada would impact the determination of a “better price”⁹ under UMIR, please discuss whether Participants (as defined in UMIR 1.1) would still be providing meaningful price improvement in circumstances where a “better price” is required.¹⁰

Question 6: Please provide any views on expected outcomes (positive and negative) associated with any changes to minimum trading increments, including as related to expected quoted volume at each price increment. Additionally, please provide your views on what metrics could be used to evaluate whether any new approach to minimum trading increments results in positive or negative outcomes.

ii) Reduce Access Fee Caps

In connection to its proposal to introduce lower variable minimum pricing increments, the SEC is proposing to reduce the access fee caps to reflect the proposed lower pricing increments. Currently, SEC Rule 610 of Regulation NMS caps exchange access fees at USD0.003 per share for securities priced greater than USD1.00 and 0.3% for securities priced below USD1.00, both of which apply to “maker-taker” and “taker-maker” fee models.¹¹

For securities priced USD1.00 or more, the SEC is proposing to introduce a variable structure for access fee caps and reduce the prescribed cap levels to USD-0.0005/share and 0.001/share based on tick size. For securities priced less than USD1.00, the access fee cap would be 0.05% of the quotation price.

In Canada, subsection 6.6.1 of National Instrument 23-101 *Trading Rules (NI 23-101)* caps fees charged by certain marketplaces for executing an order against a displayed order based on whether the security is inter-listed or non-inter-listed. Fee caps for inter-listed securities are set at

⁹ UMIR 1.1 defines a “better price” to mean, in respect of each trade resulting from an order for a particular security:

(a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and

(b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.

¹⁰ For example, see the requirements respecting dark liquidity under UMIR 6.6 as well as the ability to execute intentional crosses at fractional trade increments provided the execution price is a “better price” for both the order to purchase and the order to sell under UMIR 6.1(3).

¹¹ The “maker-taker” marketplace fee model charges a fee for the execution of an order that removes liquidity from an order book and pays a rebate to the provider of liquidity for the same transaction. The “taker-maker” fee model pays a rebate to an order that removes liquidity from an order book and charges a fee for the execution of an order that provides liquidity.

CAD0.0030 per share for securities priced greater than CAD1.00, and CAD0.0004 per share for securities priced below CAD1.00, while fee caps for non-inter-listed securities are set at 0.0017 per share for securities priced greater than CAD1.00, and CAD0.0004 per share for securities priced below CAD1.00. The fee caps only apply to “maker-taker” fee models.

Question 7: Please discuss whether fee caps should also apply to “taker-maker” fee models and, if so, whether their fee caps should be different.

Question 8: Generally, the exact fee or rebate for an order cannot be determined until after an execution occurs, as discounted fees or credits are determined by marketplaces at the end of the month, based on trading during the month of a Participant. To be able to calculate the full cost of a transaction at the time of execution, the SEC also proposes to require that all exchange fees and rebates be determinable at the time of execution. U.S. trading venues would be required to set such volume thresholds or tiers using volume achieved during a stated period *prior* to the assessment of the fee or rebate so that market participants are able to determine what fee or rebate level would be applicable to any submitted order at the time of execution.

Please discuss whether we should take a similar approach in Canada.

Question 9: If adopted as proposed by the SEC, please provide your views on a Canadian approach to fee caps, including with respect to:

- (a) harmonization with an amended SEC rule, including with respect to application to inter-listed and/or non-inter-listed securities,
- (b) methodology used, including with respect to:
 - i. application to all securities, regardless of price,
 - ii. consideration of a fee cap that reflects tick size, similar to the methodology proposed by the SEC, and
 - iii. consideration of a percentage-based fee cap for securities priced under CAD1.00.

iii) Enhance Transparency about Better Priced Orders Available in the Market

On December 9, 2020, the SEC adopted the MDI Rules, but has not set an effective date for them. These rules expanded the content of core market data that will be made available for dissemination in the NMS and adopted a new decentralized model for its consolidation, collection, and dissemination.

The MDI Rules amendments relevant to the SEC Proposed Amendments discussed in this notice are with respect to the Regulation NMS Amendments regarding the inclusion of a definition for “round lots,” as opposed to relying on exchange rules, and to require odd-lot order details be made available on market data feeds.

In the U.S., information on NMS stock quotations is provided in round lots, which, until the round lot definition adopted pursuant to the MDI Rules is implemented, continues to be defined in exchange rules, which for most NMS stocks is 100 shares. To increase transparency about the best priced quotations available in the market, the U.S. MDI Rules specifically prescribe the following

round lot size based on its share price:

- (i) for NMS stocks priced \$250.00 or less per share, a round lot will be 100 shares;
- (ii) for NMS stocks priced \$250.01 to \$1,000.00 per share, a round lot will be 40 shares;
- (iii) for NMS stocks priced \$1,000.01 to \$10,000.00 per share, a round lot will be 10 shares;
and
- (iv) for NMS stocks priced \$10,000.01 or more per share, a round lot will be 1 share.

For Canadian equity (or similar) securities, CIRO's UMIR defines "standard trading unit" to mean:

- (i) 1,000 units of a security trading at less than \$0.10 per unit,
- (ii) 500 units of a security trading at \$0.10 or more per unit and less than \$1.00 per unit,
and
- (iii) 100 units of a security trading at \$1.00 or more per unit.

In Canada, any order with volume less than a standard trading unit is considered an odd lot order. Odd lot orders are not currently considered in the national best bid and offer as they are considered "special terms orders" that do not trade in regular order books. Despite this, information about odd lot orders is readily available in marketplace data feeds.

Our preliminary view is that enhancing the transparency of better priced orders does not need to be addressed in Canada. The transparency of order and trade data is sufficient in Canada due to the availability of odd lot data and the lack of off-exchange trading.

Question 10: Please discuss if you share our assessment and provide any additional considerations in this area.

Regulation Best Execution

NI 23-101 and CIRO's Investment Dealer and Partially Consolidated (**IDPC**) Rules¹² define "best execution" as obtaining the most advantageous execution terms for a client order reasonably available under the circumstances. Dealers are required to have appropriate policies and procedures and make reasonable efforts to achieve best execution. Factors to consider include price, overall cost of the transaction, liquidity, and speed and certainty of execution. Dealers should regularly review their best execution policies and procedures, and at least annually according to CIRO IDPC Rules.¹³

With respect to the provision of the SEC Proposed Amendment relating to best execution to address potentially conflicted transactions in connection to PFOF, we note that UMIR 7.5 has the effect of prohibiting PFOF by a dealer.

Our preliminary view is that the SEC Proposed Amendments in connection to Regulation Best Execution are not dissimilar to the existing best execution requirements in Canada and therefore, should likely have no implications for the Canadian best execution regime and no impact on Canadian capital markets.

¹² IDPC Rule 3100 Part C – Best Execution of Client Orders.

¹³ IDPC Rule section 3126 – Review of best execution policies and procedures.

Question 11: Please discuss if you share our assessment and provide any additional considerations in this area.

Disclosure of Order Execution Information

Currently, the Canadian securities regulatory framework does not include requirements for disclosure by dealers and marketplaces of information related to order execution quality.

In 2007¹⁴ and 2008,¹⁵ the CSA published for public comment certain amendments to the relevant national instruments that would have introduced such disclosure requirements. In particular, marketplaces would have been required to publish monthly reports on liquidity, trading statistics and speed and certainty of execution, similar to SEC Rule 605.

Dealers would have been required to publish quarterly reports on routing of orders when acting as agent, including information as to which marketplaces orders were being routed to for execution, and specifying the percentage of those orders routed at the direction of the client as opposed to the dealer's discretion, similar to SEC Rule 606.

Since the public comments received in response to these proposals were mixed and did not communicate a clear stakeholder position, a decision was made at that time to not proceed with the proposals, but rather to continue to monitor developments in other jurisdictions regarding best order execution reporting requirements, and to monitor the impact of the evolving multiple marketplace environment.

Our preliminary view is that, since we do not have equivalent disclosure requirements as SEC Rule 605, the SEC Proposed Amendments with respect to disclosure of order execution information should not affect Canadian markets.

Question 12: Please discuss if you share our assessment and provide any additional considerations in this area.

Order Competition Rule

Under National Instrument 21-101 *Marketplace Operation*, an "exchange-traded security" is a security listed on a recognized exchange. Correspondingly, CIRO's UMIR 6.4(1) prohibits any marketplace participant from trading in or participating in a trade in listed securities by means other than entry of an order on a marketplace unless an exemption is available. Additionally, Companion Policy 21-101CP *Marketplace Operation* clarifies that two characteristics of a marketplace are that it brings together orders for securities of multiple buyers and sellers and that it uses established, non-discretionary methods under which the orders interact with each other.

Our preliminary view is that the issues addressed by the SEC Proposed Amendment concerning

¹⁴ See [Notice and Proposed Amendments](#).

¹⁵ See [Notice and Proposed Amendments](#).

order competition do not exist in Canada. In Canada, orders are generally not permitted to be executed internally by a trading venue or dealer that restricts order-by-order competition.

Question 13: Please discuss if you share our assessment and provide any additional considerations in this area.

IV. Next Steps

We will continue to engage in dialogue with stakeholders and endeavour to discuss and coordinate any potential rule changes with our U.S. colleagues, where appropriate. Any proposals to introduce or amend requirements under securities law or CIRO rules will be published in separate notices for comment. However, in the interim, we welcome any input or comments by December 4, 2023 on potential impacts of the SEC Proposed Amendments on Canadian capital markets.

V. Questions

Questions and comments may be referred to:

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