



Montreal Exchange

Regulatory Division

Consultation Paper: Introduction of a New Client Identifier and Other Marker at Order Entry

June 29, 2021

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PART 1 – INTRODUCTION

The Division proposes to introduce a unique client identifier and five additional predetermined tags at order entry. These new requirements will enhance regulatory data and thereby improve the supervision of Participants as well as the trading activity conducted on the Bourse.

1.1 The Division proposes to introduce a requirement to provide a unique client identifier (a “Client ID”) for each order sent to the Bourse. The Division does not expect the beneficial owner to be identified unless that information is available to the Approved Participant. The first level client of the Approved Participant is sufficient. A unique Client ID provided on a pre-trade basis significantly improves market surveillance efficiency and effectiveness by:

- improving the quality of alerts and as a result better identifying potentially manipulative activity;
- providing more effective and comprehensive pre-trade controls; and
- reducing the number of information requests sent to Participants.

1.2 The Division proposes to introduce additional predetermined tags to address scenarios where orders are for several clients and the Client ID is not readily available. Where the rules permit such scenarios, the Division would require either the tag Multi-Client (MC Marker) or Bundled (BK Marker) to be provided at order entry.

The Division also proposes three other predetermined tags for orders: (1) sent using sponsored access (SA Marker), (2) automatically generated on a predetermined basis, or by way of automated trading, (AT Marker), and (3) representing pre-arranged transactions¹ (PA Marker).

All these additional predetermined tags are referred to as “Additional Markers” in the document.

These new requirements will improve the risk management, surveillance and investigatory capabilities of the Division. The Division is thereby seeking input from Approved Participants, vendors, and clients to identify the solution that will best serve the needs of all stakeholders.

¹ Intentional cross

PART 2 – SCOPE

2.1 Client ID

The Division proposes that all orders sent to the Bourse on behalf of a client account² be tagged with a Client ID. The Client ID needs to be a valid Legal Entity Identifier (“LEI”)³ in line with Global Legal Entity Identifier Foundation (GLEIF). Where an LEI does not exist, a Client ID must be assigned by the Approved Participant, such as the full account number as it appears in the Approved Participant records.

2.2 Additional Markers and Exemptions

The Division proposes Additional Markers and contemplates exemptions for specific situations. (Please see Part 4 - Additional Markers and Exemptions section below)

Initially, orders not respecting the new requirements proposed in this document would not be rejected, though this allowance may be reviewed over time depending on the level of adoption.

PART 3 – APPLICATION

The requirement to enter a Client ID and all Additional Markers at order entry would apply to all Approved Participants (Canadian Participants and Foreign Approved Participants).

However, with regards to a Client ID, where the client is a foreign broker through which non-Canadian clients are accessing the Bourse, the LEI of the foreign broker would be sufficient. For client orders that are entered through an Approved Participant by a foreign broker and are automatically generated on a predetermined basis, the Approved Participant would need to provide the LEI of the foreign broker as the Client ID and a unique identifier for the end-client (“End-Client ID”) whose orders are automatically generated on a predetermined basis.

² Client Account (Compte Client) means an account for a client of an Approved Participant, for Securities or Futures Contract Transactions but does not include an account in which a member of a self-regulatory organization, or a Related Firm, Approved Person or employee of such an Approved Participant, member or Related Firm, as the case may be, has a direct or indirect interest, other than an interest in a commission charged.

³ The term “legal entity identifier” means the unique identification number attributed to a legal entity by any organization accredited to this effect pursuant to the ISO 17442 standard of the International Standardization Organization, as approved by the Financial Stability Board and the G-20 and aiming at implementing a universal and mandatory identification system for legal entities trading any type of Derivative Instrument.

PART 4 – ADDITIONAL MARKERS AND EXEMPTIONS

4.1 Additional Markers

The Division proposes to introduce Additional Markers. For specific orders sent to the Bourse, the following designation would be required:

4.1.1 Orders sent through sponsored access⁴ would need to be tagged with the “SA Marker”. This SA Marker will improve the surveillance of trading activity that occurs through sponsored access. Currently, Approved Participants are required to provide unique identifier information for all clients accessing the Bourse through sponsored access. The combination of this new marker and the unique client identifier requirement discussed above would replace the current requirement to provide a unique client identifier for Sponsored Access⁵ when the client ID is an LEI. Where the Client ID is not an LEI, Approved Participants would still need to identify to the Division their clients that are provided with Sponsored Access;

4.1.2 Orders that are automatically generated on a predetermined basis would need to be tagged with the “AT⁶ Marker”. This tag will help the Division distinguish between the various types of order flow and assess the associated inherent risks.

There are other scenarios where information is either not readily available at order entry or is not efficient to provide. The following markers would address such situations, where permitted by Bourse rules:

4.1.3 Orders entered for more than one client order from clients that do not have a common parent entity (no principal or non-client order) would require a Multi-Client Marker (MC Marker).

If an order is entered by a portfolio manager, trading on behalf of multiple funds, each with its own LEI, we would expect no marker and that the LEI of the parent be marked on the order as Client ID.⁷

4.1.4 Client order combined with principal order and/or non-client order would be tagged with a Bundled Marker (BK Marker). Or said differently, the BK marker would be required for multiple orders that are aggregated but do not belong to the same client.

⁴ As per Article 3.5 of the Rules of the Bourse - https://rules.m-x.ca/w/mx/en#/b/a3_5

⁵ Subparagraph 3.5(b)(vii).

⁶ Referred to Regulation 23-103 respecting Electronic Trading and Direct Electronic Access to Marketplaces (V-1.1, r. 7.1)

⁷ Approved Participants should provide the most granular information that they have at the time of reporting. Approved Participants should report trade allocations if they have received the allocations at the time of reporting. For example, if at the time of reporting, the Approved Participants have allocations for individual sub-funds that have separate LEIs, the Approved Participants would report the allocations using each subfund's LEI. If the Approved Participants do not have separate LEIs, the Approved Participants would report each allocation using the parent's LEI. Allocations made after the time of reporting do not need to be provided to the Division. The Division may request this information at a later date and Approved Participants should continue to maintain records of the allocations for audit trail purposes.

Once allocation instructions are received, the information would not need to be provided to the Division but would need to be readily available should the Division require such information.

4.2 Exemptions

Finally, if there are legal limitations preventing the reporting of client LEIs in the client's jurisdiction, the Approved Participant would need to apply for an exemption from the requirement to provide an LEI for its client. Exemption applications should include the following information:

Account information for the client, which includes at a minimum:

- Account information for the client, which includes at a minimum the client's name, account number and location.

Evidence of reasonable efforts by the Approved Participant to obtain the client LEI, which may include:

- the Approved Participant's policies and procedures regarding its process on client outreach;
- correspondence between the Participant and the client;
- an explanation of the legal barrier preventing the Participant from providing the client LEI, which may be in the form of a legal opinion.

The Division's authority to grant this exemption as well as the exemption regime itself, would need to be added to the Bourse rules.

PART 5 – ENCRYPTION

The Division proposes that any Client ID has the potential to be encrypted in transit and at rest to ensure that it is only accessible by the Division, should the Approved Participant choose to encrypt it.

The order markers would not be encrypted.

PART 6 – PHASE-IN

The Division proposes to create a working group composed of maximum 20 individuals employed and authorized by participants to assess the proposal including regulatory and technological modifications and make suggestions to the Division. An individual representing a third party service provider may also be eligible to participate so long as they are referred by a Participant. The Division proposes creating the working group immediately, and for all suggestions to be presented to the Bourse and Division by September 30, 2021.

The Division is targeting the third quarter of 2021 to communicate implementation timelines and technical notice to stakeholders to allow for appropriate budget and technological planning for 2022. The Division proposes that the requirements be presented to the Bourse executive committees in the second quarter of 2022 for approval but include a 6 month implementation period. The Division wants the stakeholders to have ample time to implement and test the proposed requirements. That way the requirements will be fully operational by the fourth quarter of 2022.

PART 7 – CONSIDERATIONS

We recognize that the Proposal may create some challenges for Participants, vendors, and clients. The Division understands that the main industry concerns appear to relate to maintaining client confidentiality, as well as the administrative and technological burden such requirements may represent. These concerns are discussed below.

7.1 Confidentiality

Approved Participants and other industry stakeholders may be concerned about client confidentiality. To protect client confidentiality, the Division proposes that Client IDs be encrypted if the Approved Participant chooses to. In the case the Client ID is encrypted, only the Division through its personnel would have the necessary keys to decrypt the information to be used for regulatory purposes. In the case the Client ID is encrypted, this information would only be disclosed to other regulators under specific circumstances.

7.2 Technological Implications

The Bourse's trading system is accessed through Independent Software Vendors ("ISVs") or the Approved Participant's internally developed trading systems. Either one of the two following protocols can be used to access the Bourse: 1) Bourse native SAIL protocol or 2) the industry standard FIX protocol. To comply with the requirements of other regulators, some Participants already provide information about their clients at order entry when using the FIX protocol.

The Bourse would make changes to its SAIL protocol to accommodate the Client ID, data encryption and additional fields for markers.

Data encryption would also require ISVs to support encryption at order entry. Participants would need to decrypt the information for internal use.

7.3 Costs

The Division recognizes that there would be associated costs for Approved Participants to obtain or generate the necessary Client IDs and to integrate them into their existing trading systems. However, we also expect that this initiative will reduce the amount of information the Division needs to request post-trade thereby reducing the Participants costs over the long term.

7.4 Benefits of Client IDs and Additional Markers

The Division considers the current proposal to be in the public interest as well as in the interest of Participants and regulators, including the Division.

7.4.1 For the market in general, the Client ID and Additional Markers should help to:

- better align the Division's requirements with the requirements of other Canadian regulators;
- more effectively address the risks of electronic trading;
- enhance market integrity and investor protection; and
- ensure consistency of information across Canadian marketplaces.

7.4.2 For Participants, Client IDs and Additional Markers should help to:

- better manage the Approved Participants' internal risks as the new information provided should enhance and facilitate the supervision of clients and their activities;
- increase efficiency by reducing the time, cost and complexity in consolidating and verifying data across different databases, business lines, asset groups and/or platforms;
- reduce post-trading information requests from the Division; and
- obtain a clearer client picture by linking activity for a client's various accounts.

7.4.3 For the Division, Client IDs and Additional Markers should help to:

- increase availability and transparency of trading data;
- reduce time and effort needed to match client orders received;
- reduce the number or scope of requests for information;
- enhance the Division's data analysis and market surveillance capabilities;
- increase the accuracy of alerts;
- reduce the number of false alerts; and
- improve insight into a specific account's trading behavior.

PART 8 - COMMENTS AND SUBMISSIONS

The Division is of the opinion that Client IDs provided on a pre-trade basis is both necessary and consistent with the requirements of other regulators. The Division welcomes comments and feedback from the various stakeholders to refine the proposed approach. While the Division appreciates comments and suggestions on all aspects of the Proposal, the Division provides

some specific questions below. Comments may be provided in paper or electronic form by August 30, 2021, at the latest.

The Division is aware that certain foreign jurisdictions have taken different approaches than the one proposed in this paper, such as the use of a short code at order entry for the Client ID, followed by a mapping of the short code to a client’s identity on a post trade basis. The Division is open to changing the proposed approach if there is consensus among the stakeholders, including the Bourse and the CDCC.

When submitting comments, please indicate on whose behalf the submission is made.

Q1.	What challenges, if any, do you anticipate in providing the Client ID information at order entry? Are there any special considerations?
Q2.	Is there any reason why an LEI should not be used? If so, under what circumstances? What alternative(s) do you propose? How can consistency with other regulatory regimes, transparency regarding trade execution and reduction of post-trade information analysis be ensured?
Q3.	Are there any rules or regulations given the jurisdiction(s) in which you operate that would be in conflict with the proposal? If so, what are they and how might they be addressed?
Q4.	What technology and/or administrative challenges do you anticipate in implementing the proposal? How could these be addressed or mitigated? Are there other technologies or systems that we should consider?
Q5	How should post-trade corrections (e.g., missing or incorrect client ID) be addressed? When? What should be the time-frame for submitting post-trade corrections and why?
Q6	Are there any other potential approaches, including approaches used by other regulators, that would achieve similar regulatory benefits with less impact on Participants? If so, please describe. ⁸
Q7	Is encrypting Client IDs the best approach to address confidentiality and privacy concerns? If not, what other approaches can be recommended? What specific concerns or challenges might there be with encryption and decryption? If encryption is the best approach, what technical details regarding encryption must be considered?
Q8	Are there other impacts not identified within this proposal?
Q9	Please provide any other comments regarding the Proposal.

⁸ For example, some European exchanges have introduced applications to generate short codes in order to help their participants comply with Regulation (EU) 600/2014 (MiFIR).

Please send your comments only to the following email addresses:

reg@tmx.com

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reg@tmx.com