CANADIAN FORUM FOR FINANCIAL MARKETS
FORUM CANADIEN DES MARCHÉS FINANCIER
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Submitted via E-Mail: Market_Regulation_Policy@ciro.ca

Market Regulation Policy
Canadian Investment Regulatory Organization
Suite 2600
40 Temperance Street
Toronto, ON M5H 0B4

Dear Sirs/Mesdames:

RE: PROPOSED GUIDANCE ON MARKETPLACE THRESHOLDS AND SINGLE-STOCK CIRCUIT BREAKERS (PROPOSED GUIDANCE)

The Canadian Forum for Financial Markets (CFFiM)/Forum Canadien des Marchés Financiers (FCMFi) is dedicated to advancing proposals that foster healthy, competitive financial markets and a resilient Canadian economy.

EXECUTIVE SUMMARY

Generally, the CFFiM agrees and supports the need for single stock circuit breakers (SSCBs) and marketplace thresholds into extended hours. "Normal" trading hours are fundamentally different form "extended" hours. This has been by regulatory design given the effective forced timing of information flows. A proactive, deliberate and decisive approach can avoid significant risk.

A framework review is recommended prior to implementation. Pending the results of that review, we note that generally tighter SSCBs could increase retail investor protection.

The basis for these recommendations are detailed below. Answers to CIRO's questions are included in Schedule A.

A. APPROACH

Generally, CFFIM agrees and supports the need for SSCBs and marketplace thresholds into extended hours. "Normal" trading hours are fundamentally different form "extended" hours. This has been by regulatory design given the effective forced timing of information flows. A proactive, deliberate and decisive approach can avoid significant risk.

B. MAIN CONCERN:

Trading client securities during periods of large informational change, but low visibility generates concerns of selective disclosure and selective processing of disclosure through information imbalances.

Extending the supply of potential liquidity does not address visibility concerns. Visibility in secondary markets is a direct factor in how disclosure is consumed and information processed by markets into price discovery.

A security is now processing information in a period of the day with greater information flows but much less visibility. Given this different information structure after hours, volatility may be greater and more frequent.

C. PROPOSED SOLUTIONS

i) Framework Review Prior to Implementation.

Given the approval of the extended CIX trading hours, the risk of unintentional unfair information flows, the proposed framework should be reviewed now, prior to implementation.

The consultation asks for input on the implementation period and suggests that data form this period may influence future changes. The data analysis is not disclosed.

There are additional considerations around data analysis that can and should be accomplished now, and prior to the Initial Implementation Period. It is recommended that volatility be studied:

- From 3:30 pm to 4:00pm
- During the MOC from the indicative closing price to the calculated closing prices.
- From the calculated closing prices and subsequently to first indicative prices (quotes) the next day,
- From indicative prices to the one-minute reference price.
- From the reference price to the first major block traded price of the day
- From MOC to the following MOO Market-on-Open Order.

This will help determine if overnight inter-day period has more or less variance than intraday period, provide some better measures of A:B testing and effectiveness of the concentration of information flows specifically as they related to the context of the Canadian marketplace and the ability of different classes (tiers) of securities to absorb information. The answer may be 'not very well,' but hard data will help understand why.

The summer months are not a good proxy for comparing the effects of information flows intraday vs. inter day, as it will compare a seasonally less liquid intraday period with expectedly illiquid intraday periods. Intra-day information flows need to be compared to functioning and normally liquid periods of time.

The appropriateness of extending existing single-stock circuit-breaker (SSCB) thresholds into extended trading hours, subject to the proposed opening and closing exceptions, depends on how the competing regulatory objectives are balanced.

Wider thresholds may be warranted because extended-hours trading can involve thinner liquidity, greater short-term volatility and significant price adjustments following the release of material information outside regular trading hours. Applying thresholds developed for regular trading hours could therefore interfere with legitimate price discovery and unnecessarily interrupt trading.

Conversely, narrower thresholds may be warranted where reduced liquidity increases the susceptibility of prices to temporary distortions, including disproportionate price movements resulting from relatively small transactions. In these circumstances, tighter controls could help preserve orderly markets and investor confidence, although they could also impede legitimate trading.

These competing considerations do not establish whether thresholds should be higher or lower. They do, however, challenge the presumption that parameters developed for regular trading hours are necessarily appropriate for extended-hours trading. The critical distinction is between price movements reflecting new information and those resulting from disorderly trading or temporary liquidity imbalances.

CIRO should therefore show how it intends to balance these competing objectives and establish an empirical framework for determining whether the proposed thresholds appropriately preserve price discovery while preventing disorderly trading and protecting market integrity.

The review should include consideration of :

- Whether there is any opportunity for gaming the next days' open presented with fluidity of information flows:

- The benefit of a one-minute reference price to match opening price on primary listing in an environment when real price discovery happens overnight

- The benefit to the primary listings venue for creating that price (Is it fair that alternative venues are given a regulatory free ride? should ATS' be required to pay for this service?)

Realities in the market may necessitate changes to the levels of parameters prior to the end of any initial implementation period. CIRO should maintain this flexibility.

ii) Tighter SSCBs

Trading participants who in a strict economic sense act like "speculators" rather than hedgers or buyers of existing economic risk will understandably seek to benefit from information arbitrage opportunities. Given this economic reality tighter SSCBs, could protect retail investors(who would not be the first to adapt to extended hours) and remain consistent with regulatory principles of fair disclosure.

D. BASIS FOR SOLUTION: INFORMATION RELEASE AND PRICE DISCOVERY

Securities prices generally reflect the relevant information, including risks, related to their underlying assets, in order for investors to collectively generate expectations about their future value. Price discovery generally acts as a process by which that information is distilled, and positive and negative expectations are balanced into generally equal probabilities.

The vast majority of cumulative (positive or negative in various trading periods) stock market returns historically occur overnight (close to open), or outside "normal" trading hours rather than during regular trading hours (open to close).

Research demonstrates that a substantial proportion of cumulative U.S. stock-market returns has historically accrued overnight, between the market close and the following opening, rather than during regular trading hours. Some studies have found that virtually all cumulative positive equity-market returns over particular historical periods occurred overnight, while regular-hours returns were negligible or negative.[1] Other research documents significant and persistent differences between overnight and intraday returns, including investment strategies whose returns accrue entirely during one period and are partially offset during the other.[2] Research on U.S. equity-index futures also identifies large and statistically significant positive returns during the opening hours of European markets.[3] These findings demonstrate the importance of overnight price discovery, although the magnitude and direction of returns vary across securities, trading strategies and historical periods.[4] This is a well-known phenomenon by managers of proprietary trading capital; and factors into their business models for generating inventory and sharing profitability with day traders' intra-day activity.

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[1] Michael J. Cooper, Michael T. Cliff, and Huseyin Gulen, "Return Differences between Trading and Non-Trading Hours: Like Night and Day" (working paper, September 26, 2008), https://doi.org/10.2139/ssrn.1004081.

[2] Dong Lou, Christopher Polk, and Spyros Skouras, "A Tug of War: Overnight versus Intraday Expected Returns," *Journal of Financial Economics* 134, no. 1 (October 2019): 192–213, https://doi.org/10.1016/j.jfineco.2019.03.011

[3] Nina Boyarchenko, Lars C. Larsen, and Paul Whelan, "The Overnight Drift," *The Review of Financial Studies* 36, no. 9 (September 2023): 3502–3547, https://doi.org/10.1093/rfs/hhad020.

[4] Nina Boyarchenko, Lars C. Larsen, and Paul Whelan, "The Overnight Drift," *The Review of Financial Studies* 36, no. 9 (September 2023): 3502–3547, https://doi.org/10.1093/rfs/hhad020.

Therefore, earnings reports are typically released overnight, macroeconomic data releases occur outside trading hours, and global and institutional sentiment is factored in deep into the night (from a price discovery perspective between 2 am and 3am)

Net price action during trading hours tends to be profit neutral over long periods, even though this is where the bulk of the volume and liquidity are. Because information is disseminated outside of normal hours, and liquidity is lesser during these periods, a "premium" is required for holding the risks of "illiquidity" and information impact. In other words, because most fundamental information is released outside market hours, it is processed into price discovery before those market hours. [1]

In addition, the dissemination of information has changed over the years. The adoption of Regulation Fair Disclosure by the United States Securities and Exchange Commission in 2000, followed by Canada's National Policy 51-201, *Disclosure Standards*, in 2002, marked an important shift toward broader and more equitable dissemination of material corporate information. [5] These initiatives responded to longstanding concerns about selective disclosure, under which issuers provided material non-public information to favoured analysts and institutional investors before making it available to the investing public. [6] Before these reforms, selective disclosure enabled issuers to confer valuable informational advantages on preferred market participants. Those receiving advance information could trade, adjust their investment positions or advise clients before other investors had access to the same information. The Securities and Exchange Commission also identified the potential for corporate management to reward favourable analysts with privileged access and to exclude analysts who expressed critical views.[7]

The reforms sought to address these inequalities by promoting broad, non-exclusionary disclosure. Although public companies frequently announce financial results outside regular trading hours, neither Regulation Fair Disclosure nor National Policy 51-201 established a general requirement to release material information after the market close. Their principal objective was to prevent preferential access to material undisclosed information, rather than to prescribe a particular time of day for disclosure.[8]

The relationship between selective disclosure and market efficiency is more complex. Earlier access to information by a limited group of sophisticated investors could facilitate the incorporation of information

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[5] Securities and Exchange Commission, *Selective Disclosure and Insider Trading*, Securities Act Release No. 33-7881, Exchange Act Release No. 34-43154, 65 Fed. Reg. 51716 (August 24, 2000), effective October 23, 2000, https://www.sec.gov/rules-regulations/2000/08/selective-disclosure-insider-trading; Canadian Securities Administrators, *National Policy 51-201: Disclosure Standards*, effective July 12, 2002, https://www.asc.ca/securities-law-and-policy/regulatory-instruments/51-201.

[6] Securities and Exchange Commission, *Selective Disclosure and Insider Trading*, section II.A, "Background"; British Columbia Securities Commission, "CSA Adopts New Policy on Disclosure Standards," News Release 2002/48, July 15, 2002, https://www.bcsc.bc.ca/about/media-room/news-releases/2002/csa-adopts-new-policy-on-disclosure-standards-csa.

[7] Securities and Exchange Commission, *Selective Disclosure and Insider Trading*, section II.A. The Commission expressly discussed privileged informational advantages, management's use of information to reward favoured analysts, and the exclusion of analysts publishing negative assessments.

[8] Securities and Exchange Commission, *Selective Disclosure and Insider Trading*, sections I and II.B.4, addressing the timing and permitted methods of public disclosure; Canadian Securities Administrators, *National Policy 51-201: Disclosure Standards*.

into market prices before its public release. However, the timing of price adjustments is only one dimension of market efficiency. Empirical research examining Regulation Fair Disclosure has found that restricting selective disclosure did not necessarily impair price discovery and, in some studies, improved the informational efficiency of prices before earnings announcements.[9] Ultimately, regulators concluded that allowing issuers to favour selected market participants with material non-public information undermined confidence in the fairness of securities markets.[10]

On a practical basis the concept of fair disclosure allows a time buffer for algorithms, financial models, and report to be digested and updated.

Regulation Fair Disclosure, together with exchange rules governing the timely dissemination of material information, substantially reduced the informational advantages associated with selective disclosure.[11] Exchange requirements for advance notification, broad public dissemination and coordinated trading halts helped establish more orderly disclosure procedures.[12] Subsequent exchange requirements also imposed specific restrictions around market-opening and closing periods.[13] Empirical research supports a significant reduction in selective informational advantages following Regulation Fair Disclosure.[14]

Extending hours brings into effect "practical" selective disclosure or "selective processing of disclosure." It is also not the case that all retail investor platforms will have the same level of transparency into extended hours that they have into the normal trading day. Professional traders will have more opportunities to trade against less informed flows precisely in the time periods where fair disclosure was pushed. Because all trading modalities are not being released in a uniform manner into extended hours (trading access, price and quotation reporting, order types, and attention)[15], professional traders will understandably find ways receive and digest information prior to the general public again, and benefit through arbitrage.

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[9] Frank Heflin, K. R. Subramanyam, and Yuan Zhang, "Regulation FD and the Financial Information Environment: Early Evidence," *The Accounting Review* 78, no. 1 (2003): 1–37; Philip B. Shane, Naomi S. Soderstrom, and Sung Wook Yoon, "Earnings and Price Discovery in the Post-Reg. FD Information Environment: A Preliminary Analysis," working paper, November 15, 2001, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=291082.

[10] Securities and Exchange Commission, *Selective Disclosure and Insider Trading*, sections II.A and V.A.1; British Columbia Securities Commission, "CSA Adopts New Policy on Disclosure Standards," July 15, 2002.

[11] Andreas Gintschel and Stanimir Markov, "The Effectiveness of Regulation FD," Journal of Accounting and Economics 37, no. 3 (2004): 293–314, https://doi.org/10.1016/j.jacceco.2003.12.001

[12] Nasdaq Stock Market, Nasdaq Listing Rules, Rule 5250(b)(1) and Interpretive Material 5250-1, https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5200-series; Toronto Stock Exchange, TSX Company Manual, sections 408–410, https://www.tsx.com/en/resource/3122.

[13] Securities and Exchange Commission, "Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Amending Section 202.06 of the NYSE Listed Company Manual," Federal Register 80 (September 9, 2015): 54362–65, https://regulations.justia.com/regulations/fedreg/2015/09/09/2015-22603.html

[14] Venkat R. Eleswarapu, Rex Thompson, and Kumar Venkataraman, "The Impact of Regulation Fair Disclosure: Trading Costs and Information Asymmetry," Journal of Financial and Quantitative Analysis 39, no. 2 (2004): 209–225, https://www.cambridge.org/core/product/identifier/S0022109000003045/type/journal_article.

E. CONCLUSION

The different information structure of extended trading hours brings the risk of greater and more frequent volatility. Trading client securities during periods of large informational change, but low visibility generates the a 'close cousin' of selective disclosure, through the selective processing of disclosure (through traders rather than issuers)creating information imbalances.

As a result, CIRO should apply volatility controls to extended trading hours. The extent to which those parameters are within an acceptable range for a security which is processing information in a period of the day with greater information flows but much less visibility, remains to be determined.

Respectfully submitted,

Canadian Forum for Financial Markets

www.CFFiM-FCMFi.ca

cc.

Trading & Markets Division
Ontario Securities Commission
2200-20 Queen Street West, Toronto, Ontario, M5H 3S8
Email: tradingandmarkets@osc.gov.on.ca

Market Oversight
Alberta Securities Commission
Suite 600
250-5th Street SW, Calgary, Alberta, T2P 0R4
Email: CIRO-Reporting@asc.ca

SCHEDULE A

Answers to - Questions on Marketplace Thresholds and SSCBs

(a) Question 1 – Initial Implementation Period

(i) Effective date of Final Guidance

"CIRO is proposing that the Final Guidance become effective no earlier than 120 days … does not expect the Initial Implementation Period to begin before May 2027. …. would a minimum 120-day period provide marketplaces and other impacted stakeholders with sufficient time to complete any necessary technology, systems or operational changes?

See enclosed.

(ii) Length of Initial Implementation Period

CIRO is seeking feedback on the appropriate length of time for the Initial Implementation Period. Data collected during the Initial Implementation Period would assist CIRO in reviewing order and trade activity during extended trading hours and assess whether further changes to the Marketplace Thresholds and SSCB frameworks are needed.

Answer: See enclosed. The data collection period should cover at least 60 trading days of normal trading volume. The duration considered should exclude the characteristically lower mid-summer weeks; the days before and after long weekends; or overlapping US holidays when the Canadian market is open.

The data will be challenged enough with skew from noise introduced into illiquid periods of the day. Further murkiness of data due to normally expected illiquidity in normal trading hours should not be included.

CIRO needs the flexibility during the implementation period to act and implement departures from the volatility parameters should real-world trading experience warrant.

Questions on Marketplace Thresholds

(b) Question 2 - Data from Initial Implementation Period to be used for Assessment

CIRO recognizes that marketplaces currently take different approaches to address incoming orders that breach Marketplaces Thresholds as long as the execution of the offending order is being precluded. This can take one of the following forms:

- rejecting the incoming order
- repricing the incoming order, or

- booking the incoming order where there is no tradable liquidity on the other side and preventing any future execution of that booked order while it continues to fall outside Marketplace Threshold parameters.

To assist CIRO in assessing the appropriateness of the Marketplace Threshold price parameters during the Initial Implementation Period, CIRO is seeking information from marketplaces about orders that breach Marketplace Thresholds. This would include all orders that are rejected, repriced, or otherwise booked but not immediately tradable. For each such order, it would be helpful if marketplaces could include the following information:

- date and time of incoming order
- market order number (also known as the Sequence Number)
- symbol
- price
- volume
- National Last Sale Price (NLSP) and One-Minute Reference Price at the time the order was received by the marketplace
- identify whether the order was rejected, repriced, or booked (but not immediately tradable) on the marketplace.

CIRO seeks feedback from marketplaces on whether it would be feasible to provide a report containing this information to CIRO at the end of the Initial Implementation Period.

We see no reason why this would not be possible given that this data is already captured and stored for clients' audit trail purposes.

(c) Question 3 – Reprice One-Minute Reference Price to Opening Trade Price only

Answer: See enclosed. As hours are further extended, this opening price will have less and less relevance as prices will be formed long before trading at what will be an artificial opening time. The question the regulators need to answer when "24 hour" trading comes about is: Which price better reflects information flows: the prices which have been digested overnight or the opening auction?

(i) Other trades resulting from an auction

CIRO is proposing the repricing of the One-Minute Reference Price only in the context of the Opening Trade2, and not in other instances such as any subsequent re-opening or closing auction later in the trading day. The reason for this proposal is that a new marketplace will now be open for a significant period of time prior to the listing exchange, which could contribute to a material difference between the pre-open trade prices and the calculated opening price on the listing exchange.

Answer: CIRO explicitly recognizes the opportunities for information arbitrage in the future. At some point, one would expect those venues which list the security to factor in the information flows developed overnight into a better balancing mechanism of those pre-open flows with the price discovery of an auction. The earlier this is given consideration, the less risk we have for impacting investor confidence.

CIRO does not expect the same degree of potential price divergence during core trading hours, including in the case of a re-opening or closing auction, because the security would generally have been trading continuously throughout the day. Re-openings and closing auctions also occur under the current framework, and CIRO has not identified any material issues related to price divergence. Accordingly, to reduce operational complexity, CIRO is proposing to require the One-Minute Reference Price to be repriced only in connection with the Opening Trade.

CIRO seeks feedback on whether commenters agree with this proposed approach.

Answer: Agreed.

(ii) Implementation Impact of Repricing One-Minute Reference Price to Opening Trade Price

In order for marketplaces to reprice the One-Minute Reference Price to the Opening Trade price as proposed, marketplaces would need to:

- identify and consume the Opening Trade price from the listing exchange
- distinguish the Opening Trade from other auctions (e.g. reopening and closing auctions) on a listing exchange.

CIRO seeks feedback on whether the above information is currently available from each of the listing exchanges as part of the market data feed in order to facilitate this implementation, and if not, whether this information may be made available by each of the listing exchanges.

[No substantive comment,(although we do not see why this should be an information burden given the existing sharing of data amongst venues.)]

(iii) No Opening Trade on Listing Exchange

In the event there is no Opening Trade on a listing exchange in a particular symbol due to limited liquidity, the first trade on the listing exchange would continue to establish the NLSP.

However, where the opening auction process on a listing exchange does not result in a trade, and the first trade on that exchange occurs later in the trading day during the continuous trading session ("first trade"), CIRO would not view that circumstance as presenting the same risk that needs to be addressed by the repricing requirement described above. Any difference between the price of that first trade on the listing exchange and prices on other marketplaces would generally be similar to the price variation that can occur during normal continuous trading. CIRO also notes that this scenario can occur today, without any corresponding obligation for marketplaces to reset the One-Minute Reference Price. Accordingly, CIRO is proposing that the requirement to reset the One-Minute Reference Price apply only in connection with the Opening Trades on a listing exchange.

CIRO seeks feedback on whether commenters agree with this proposed approach.

No comment.

Question on SSCBs

(iv) Question 4 – Operation of SSCBs near opening

CIRO is proposing that SSCBs begin operating at 7:00 a.m. ET during extended trading hours, with wider trigger levels applying from 9:00 a.m. to 9:30 a.m. ET to account for potential volatility near the opening of the regular trading session. During this period, Marketplace Thresholds would continue to operate as the first layer of protection against erroneous orders and short-term unexplained price movements. For SSCB-eligible securities, the applicable Marketplace Threshold would remain at 10%, such that a single incoming order that would execute outside the applicable threshold would be rejected, repriced or otherwise prevented from executing.

Accordingly, under the proposed wider SSCB parameters, an SSCB would generally only be triggered during the pre-opening period where a series of orders causes the price of the security to move by at least 20% and 40 trading increments within five minutes.

CIRO seeks feedback on whether:

- Applying wider SSCB trigger levels appropriately balances the need to address potential volatility near the open with the objective of maintaining volatility controls during extended trading hours? In the event a SSCB is triggered near the open, there is a possibility of delaying the Opening Trade on the Primary Listing Exchange.

Answer: The goal of the regulators should be the fair processing of information into the price discovery process, whether by removing selective disclosure or selective processing of disclosure; not the concern of delaying opening trades.

But to the extent that frequent delays demonstrate an inefficiency of getting that information process to translate into the continuous market; this supports tighter SSCB levels. If the SSCB is tight enough, the stock will not trade until it is expected that there is enough time for the information (through the pre-open process) and attention (through the auction process) to properly price it.

- SSCBs should continue to operate during the pre-opening period, rather than be suspended, during extended trading hours?

Answer See enclosed.