

Responsive Market Regulation – Comments on 2017 OSC Paper

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In a world where money flows rapidly between established markets and a growing number of innovative markets in multiple jurisdictions, it is an increasing challenge for regulators to “keep up” with capital market regulation and to protect investors while fostering fair and efficient capital markets and confidence in capital markets. Ontario Securities Commission (OSC) personnel recently published some “big picture” thinking on this challenge in an April 2017 paper presented at Oxford University called [*A Framework for Responsive Market Regulation*](#) by Timothy Baikie, Tracey Stern and Maureen Jensen (the “Paper”).

The Paper is about trading. It submits that “A regulator’s *raison d’être* is not simply to respond to market issues but to understand the changes and business drivers in the marketplace and to have the courage to foster a responsive regulatory climate that allows innovation to occur while ensuring core principles such as investor protection are preserved, and that the impact of any change is monitored.”

In looking at the regulation of capital markets, the OSC acknowledges that it can create an environment for fair and efficient markets, but it cannot require anyone to use them. It can set standards, but also has to recognize when regulatory action is not needed and may be counterproductive or have unintended consequences. Working with regulators in other jurisdictions, IIROC, the exchanges and innovators, it has to try to anticipate changes in the markets.

The Paper cites examples of past market structure issues and policy development, including efforts to pursue a vision of an ideal market that saw the 1999 trading realignment, such that all senior issuers traded on the Toronto Stock Exchange, junior issuers on the Canadian Venture Exchange and derivatives on the Montreal Exchange, to create a competitive framework for new marketplaces.

That was followed by a review of market fragmentation and a special committee report recommending maximizing market integrity; ensuring fairness for all participants; and maximizing liquidity, real-time transparency and price discovery. Rules were adopted to support the ideal market vision, including oversight of alternative trading systems. Then issues of order protection and “dark trading” regarding pre-trade transparency were addressed. The OSC is continuing to try to accommodate innovation in areas including addressing hi-frequency trading with pre-trade controls, post-trade monitoring and access cut-offs in the event of disorderly trading to manage technological risk. It has also introduced order processing delay “speed bumps”.

There is a recognition that not all rules have been successful and a number have had to be revisited and revised multiple times. The Paper says “Policy analysis must be both reactive and anticipatory.”, and that “Policy decisions must be regularly revisited to identify if there have been unintended consequences or market developments that necessitate a review because they were not anticipated at the time a rule or policy was made.”

It is helpful to know the OSC has a vision about ideal markets, and is thinking about its role in the future of market regulation, as we see the traditional exchanges moving away from that role with the Toronto Stock Exchange pursuing its vision “to be a technology driven solutions provider that puts clients first”.

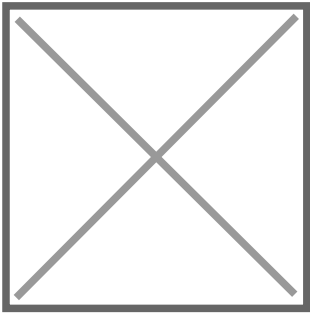
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Gardiner Roberts

Bay Adelaide Centre — East Tower
22 Adelaide Street West, Suite 3600
Toronto, ON M5H 4E3

Phone: 416.865.6600
Fax: 416.865.6636
contactGR@grllp.com

Author



Heather Zordel

Gardiner Roberts

Bay Adelaide Centre — East Tower
22 Adelaide Street West, Suite 3600
Toronto, ON M5H 4E3

Phone: 416.865.6600
Fax: 416.865.6636
contactGR@grllp.com