

Headnote

Application for relief under s. 15.1 of National Instrument 21-101 *Marketplace Operation*, s. 12.1 of National Instrument 23-101 *Trading Rules*, and s. 10 of National Instrument 23-103 *Electronic Trading and Direct Access to Marketplaces* – relief from the application of all provisions of the Marketplace Rules that apply to a person or company carrying on business as an alternative trading system in the Jurisdictions – relief granted subject to terms and conditions.

Applicable Legislative Provisions

- Section 15.1 of NI 21-101;
- Section 12.1 of NI 23-101; and
- Section 10 of NI 23-103.

Citation: Re BMO Nesbitt Burns Inc., 2021 ABASC 183

Date: 20211214

In The Matter of
the Securities Legislation of
Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland And Labrador,
Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island, Quebec,
Saskatchewan, And Yukon
(the “**Jurisdictions**”)

and

In the Matter of
The Process for Exemptive Relief Applications
in Multiple Jurisdictions

and

In the Matter of
BMO Nesbitt Burns INC.
 (“**BNBI**” or the “**Applicant**”)

Decision

Relief Requested

The securities regulatory authority or regulator in each of the Jurisdictions (each a “**Decision Maker**”) has received an application (“**Application**”) from the Applicant for a decision under the securities legislation of the Jurisdictions (the “**Legislation**”) for an exemption under section 15.1 of National Instrument 21-101 -- *Marketplace Operation* (“**NI 21-101**”), section 12.1 of National Instrument 23-101 -- *Trading Rules* (“**NI 23-101**”) and section 10 of National Instrument 23-103 - *Electronic Trading and Direct Access to Marketplaces* (“**NI 23-103**”) (together, the “**Marketplace Rules**”), exempting the Applicant from the application of all provisions of the Marketplace Rules as those provisions apply to a person or company carrying on business as an alternative trading system (“**ATS**”) in the Jurisdictions (the “**Requested Relief**”).

Under the Process for Exemptive Relief Applications in Multiple Jurisdictions (for a coordinated review application):

- (a) the Ontario Securities Commission (“**OSC**”) is the principal regulator for this Application (“**Principal Regulator**”); and
- (b) the decision is the decision of the Principal Regulator and evidences the decision of each other Decision Maker.

Interpretation

Terms defined in National Instrument 14-101 – *Definitions* have the same meaning if used in this decision, unless otherwise defined.

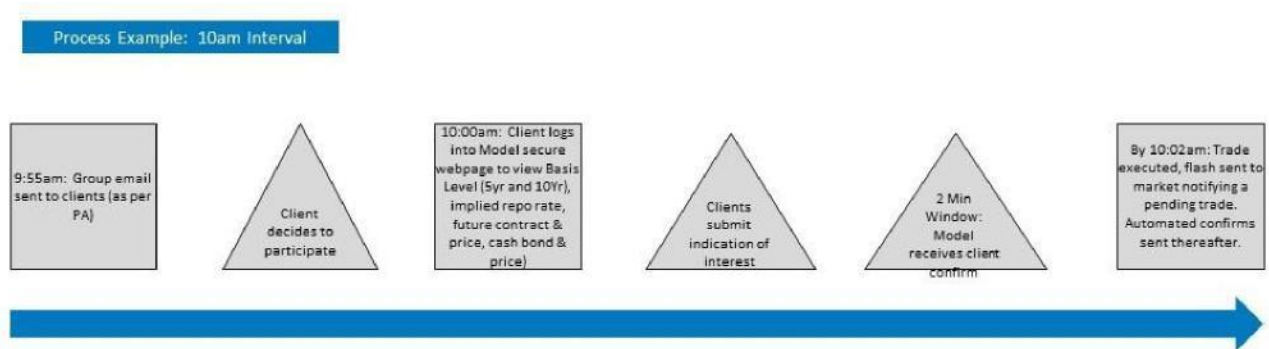
Representations

This decision is based on the following facts represented by the Applicant:

1. BNBI is amalgamated under the laws of Canada and is an indirect subsidiary of the Bank of Montreal, a bank listed in Schedule 1 of the *Bank Act* (Canada). BNBI is a dealer member of the Investment Industry Regulatory Organization of Canada (“**IIROC**”) and is registered as an investment dealer with the securities regulatory authority in each province and territory of Canada and is an Approved Participant of the Bourse de Montréal. BNBI’s head office is in Toronto, Ontario. Accordingly, the OSC has been selected as the Principal Regulator for this Application.
2. The Applicant is not in default of securities legislation in any of the Jurisdictions.
3. A basis trade, as contemplated in this Application for exemptive relief, is comprised of two components: the simultaneous purchase or sale of a debt security and an offsetting trade in a corresponding futures contract that may also be a 'commodity futures contract' or 'exchange contract' as defined in some Jurisdictions.
4. The Requested Relief shall apply only to basis trades in Government of Canada bonds (“**GoC bonds**”) and the corresponding futures contracts listed on the Bourse de Montréal (“**Bourse futures contracts**”).
5. The Applicant intends to initiate an electronic transaction solution for the execution of basis trades on behalf of institutional clients for which the Applicant has developed an automated model (the “**Model**”).
6. The Model is an electronic system that, in relation to securities, brings together buyers and sellers, brings together orders from multiple buyers and sellers, and utilizes established non-discretionary methods under which orders interact with each other. This means that the Model meets the definition of “marketplace,” as that term is defined in the Marketplace Rules and pursuant to the securities legislation of the Jurisdictions. As a result, in the absence of the Requested Relief, the Marketplace Rules would require authorization of BNBI as an ATS.

7. Trading using the Model will be governed by and conducted in accordance with a Participation Agreement (“PA”) between BNBI and each participating client.
8. Each participating client will be provided with training materials regarding use of the Model, including as it relates to the procedures for the entry and trading of orders on the Model.
9. The Model will establish a platform where participating clients may, in relation to a basis trade, express interest at a price set by BNBI at pre-set times on a daily basis (up to five times daily). Timing and number is to be determined and may be adjusted over time according to participating client needs and servicing requirements.
10. Efficiencies of the Model include:
 - (a) pricing for the basis trade is delivered electronically at set times;
 - (b) a more efficient manner in assessing participating client interests in the basis trades at set-times versus ad-hoc;
 - (c) participating clients will be able to indicate their interest in a basis trade anonymously, thus allowing the participating client not to show their full size to the market, while minimizing the potential for information leakage or market dislocation;
 - (d) the platform underpinning the Model automates participating client risk limits;
 - (e) the platform automates acceptable trade counterparties to inhibit trades between counterparties that would be proscribed under trading rules or as a result of investment mandates; and
 - (f) GoC bond trades are electronically processed (versus manual), with automated ticketing that satisfies the participating client’s compliance and audit requirements.
11. The Model is designed to allow participating clients at set times, on a daily basis, to express interest in a basis trade for the simultaneous execution of GoC bonds with a minimum notional value of \$25 million and at notional increasing increments of \$5 million, together with and the offsetting quantity of the corresponding Bourse futures contracts.
12. Each participating client will have a set time period (“Window”) to express this interest at each set time per day. Prior to the Window, BNBI will establish the trade point based on recent market activity levels.

13. If the buy-side and the sell-side of a basis trade each has interest at the established trade point, each participating client will be required to confirm its bid or offer. Upon both parties confirming their interest, a match occurs.
14. Matching of buy-side and sell-side interest will be conducted on a time priority basis subject to the effect of the automated participating client risk limits and counterparty controls.
15. Each match will result in the Bourse futures contract component of the basis trade being posted to the Bourse de Montréal pursuant to existing Bourse regulations applicable to 'Exchange for Physical' ("EFP") transactions, which include requirements for the 'reasonable' pricing of the basis trade, prohibitions on reporting 'wash trades', maintenance of appropriate books and records, and the public reporting requiring of the component futures trade. No trade will officially exist until it has been accepted and posted by the Bourse de Montréal.
16. The following diagram provides an illustrative example of the process used by the Model:



17. Only institutional clients (clients defined as "Institutional Customers" pursuant to the IIROC Dealer Member Rules (the "IIROC Rules") are permitted to trade using the Model. The current definition of an Institutional Customer pursuant to the IIROC Rules does not include natural persons.
18. Each client permitted to trade using the Model will have been appropriately onboarded by BNBI prior to being provided access to trade using the Model. Each such participating client will also have been onboarded by BNBI as a participating client for Bourse futures contracts.
19. Access to enter orders or to trade on the platform will be limited to personnel of the participating client that have been identified by the participating client to BNBI as 'eligible traders'.
20. In accordance with the terms of the PA, BNBI may deny or revoke access to the Model for any participating client that is deemed to have engaged in any activity which, in BNBI's estimation, is detrimental to the fair and equitable use of the platform or is

otherwise deemed to be detrimental to market integrity. BNBI shall provide any participating client whose access has been denied and/or revoked with an explanation for such denial and/or revocation.

21. BNBI will not regulate participating clients or their conduct, other than as it relates to conduct in respect of the trading on the platform, and will not discipline participating clients other than by exclusion from participation on the platform in accordance with the terms of the PA.
22. Stakeholders from Bank of Montreal, BNBI or related parties may participate on the platform. Each such stakeholder will participate on an arms-length basis in accordance with the terms of the PA. The terms of the PA for such stakeholders will be materially similar to the PA applicable to other participating clients.
23. BNBI will enforce strict information barriers to ensure that all participating clients, including related parties, will have no information advantages. These information barriers will apply to any related parties granted access to the Model to ensure that no informational advantages accrue.
24. The potential conflict of interest associated with related party access to the Model will be disclosed to all participating clients.
25. BNBI will ensure that all personnel responsible for the operation or administration of the Model are not permitted to participate in trading on the platform and would not be individuals responsible for voice-brokering basis trades.
26. The Model, in all material respects, simply automates trades that are currently voice-brokered trades.
27. All trades executed using the Model will be governed by the IIROC Rules which currently apply to the Applicant's current voice-brokered basis trades, including obligations to maintain client confidentiality, manage conflicts of interest and maintain appropriate books and records.
28. Information in respect of the GoC bond component of each basis trade will be reported to IIROC pursuant to IIROC Rule 2800C—Transaction Reporting for Debt Securities.
29. Notwithstanding Representation 6 set out above, the Applicant submits that the underlying policy reasons for the application of the Marketplace Rules to an ATS do not apply in the case of the Model and so the Applicant should be exempt from the Marketplace Rules.
30. In addition, the Applicant further submits that:
 - (a) the operation of the Model does not disadvantage market participants and does not interfere with the functioning of the existing basis market or the markets for the

component GoC bonds and Bourse futures contracts;

- (b) the operation of the Model provides a more effective means for participating clients to enter into basis trades;
- (c) access to the Model and trading will be limited to 'sophisticated' BNBI customers that meet the IIROC definition of 'Institutional Customer', that have been onboarded as eligible to trade Bourse futures contracts, and that are able to participate with minimum order sizes that will reflect notional interest of at least \$25 million;
- (d) all trades executed using the Model will be governed by the IIROC Rules, which currently apply to the Applicant's current voice-brokered basis trades;
- (e) BNBI will not be regulating participating clients or their conduct, other than as it relates to conduct in respect of the trading on the platform, and will not discipline participating clients other than by exclusion from participation on the platform;
- (f) information in respect of the GoC bond component of each basis trade will be reported to IIROC pursuant to IIROC Rule 2800C—Transaction Reporting for Debt Securities;
- (g) the Bourse futures contract component of each basis trade will be routed through the facilities of the Bourse de Montréal and all requirements governing EFP transactions will continue to apply;
- (h) implementation of the Model will provide significant efficiencies for participating clients;
- (i) BNBI has developed and will apply a system of processes and controls governing electronic access and use of the Model, and such processes and controls are intended to provide for the resiliency, integrity, reliability and cybersecurity of the Model; and
- (j) the Model provides the potential for enhanced liquidity and significant efficiency enhancement for participating clients, while bolstering market integrity for the underlying basis product.

Decision

Each Decision Maker is satisfied that the decision meets the test set out in the Legislation for the Decision Maker to make the decision.

The decision of the Decision Makers under the Legislation is that the Requested Relief is granted provided that:

- (a) BNBI will limit the use of the Model to basis trades involving offsetting positions in GoC bonds and the related Bourse futures contracts;

- (b) BNBI will continue to be registered in as an investment dealer in each jurisdiction in which the trading services under the Model are being offered and will maintain its Dealer Member status with IIROC and its Approved Participant status with the Bourse de Montréal; and
- (c) BNBI will promptly notify the Principal Regulator of any material changes to:
 - (i) the Model, including the conditions upon which access to trading is granted to participating clients;
 - (ii) BNBI's business or operations, or the information provided in the Application, as these material changes relate to BNBI's offering of the basis trading services; and
 - (iii) IIROC or Bourse de Montréal requirements applicable to trades in the component GoC bonds and related Bourse futures contracts, including the Bourse de Montréal requirements applicable to EFP transactions.

Dated this 14th day of December, 2021

"Tracey Stern"

Manager, Market Regulation
Ontario Securities Commission