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Dear Sirs/Mesdames:

ITG would like to thank the Ontario Securities Commission for this opportunity to comment on the application of the proposed changes to the CSE Market Maker program.

ITG has been a long standing participant in the Canadian equity markets, and a strong proponent of innovation, healthy markets and competition. We believe in markets that serve real investors, and allow for the greatest competition for each trade.

The proposed amendments, as best we understand them, will allow market makers that have been designated by the CSE, to trade versus retail style flow, at the existing CBBO even when the CSE doesn't have a bid or offer at that price. We have a variety of concerns around this proposal.

1) To the best of our knowledge, the size that the designated market maker is willing to trade, on any given issue, will not be public and may change during the day. The very notion that one participant can selectively inform a subset of participants (eg some or all of the Canadian retail desks) of electronically executable orders, without informing all like clients most certainly violates the foundational tenants of our fair access rules. To be clear, we believe this is true of both the existing GMF facility, as well as the AEF facility,

and are at a loss to explain how either of them was approved in their current form. We will almost certainly be writing similar comments in our letter regarding the just proposed TMX Market Maker program revisions.

2) The new facility allows for chosen intermediaries to trade, versus small flow, at the touch without quoting visibly. At the same time, we do not allow retail or institutional investors to capture liquidity in this manner. Why are we allowing intermediaries, with no obligation, the ability to cherry pick the least short term informed flow in a manner longer term investors cannot. What macro prudential policy objective is met by tilting the field even further in the favour of short term intermediaries?

3) The explanation of the proposal is lacking in detail, resulting in street wide confusion around the actual operation of the facility. For example, the document does not make it clear when and how market makers can turn on, or off, participation features, or how the street would be notified of such a change. We also don't know if minimum fill orders can be used within the facility. This is a growing concern in Canada, where many marketplace websites do an inadequate job of describing how various marketplace order types and facilities work, and the markets grant asymmetrical information around their operations to differing participants. We believe the CSA needs to strongly enforce existing marketplace transparency rules, such that all participants can confidently utilize the facilities on offer.

4) The proposal itself is in direct conflict with CSE's own responses to concerns about the original GMF facility. During that comment period the CSE suggested the GMF facility doesn't violate the dark rules by quoting from the introduction of UMIR 6.6, where IIROC states that TSX market maker participation doesn't violate the dark rules, due to the obligation undertaken by the market maker. But later, in the very same letter the CSE states "The CSE does not accept the characterization of RT participation...as an "obligation". The participation feature may be turned on and off intraday at the discretion of the market maker on the TSX". As the GMF can also be both turned off, and dialed down intraday, it would seem it does not meet the CSE's own definition of an obligation. As they have clearly stated that the reason the GMF is exempt from the dark rules is because of the market maker obligation, we seem to have a problem. By their own definition the CSE facility does not meet the bar required to trade in the manner in which it is designed to operate.

   Similarly, in a response to the CSTA the CSE justifies the previous iteration of the GMF facility by highlighting that "marketable orders are directed to the market, contributing to price discovery and liquidity". A few short weeks later they have proposed a facility designed to capture orders that are sent away from the market contributing to price discovery and liquidity.

   Also within the document the CSE argues that there is a strong likelihood that institutional flow, rather than just retail flow, will access this facility. We strongly disagree with this statement for a multitude of logistical reasons, and would like to see the CSE further explain how they came to such a conclusion.

5) Finally, we note that this facility, like the Alpha speed bump, is designed to attract retail style orders by offering benefits to dealers that are willing assign additional latency and missed quote risk to a client. This client does not participate in any upside. How can this possibly be allowed in a best execution environment? We certainly would never subject our clients to a facility with highly uncertain fills, without offering real benefits in the form of price improvement. The regulators really need to clarify how these offerings fit within a best ex environment.

In November of 2010, the CSA and IIROC jointly published a position paper on dark liquidity in Canada[1] . Section II (III) of that paper states “The posting of limit orders in a visible book is important to maintain the quality of price discovery. To achieve this, limit orders should ideally be directed to, and displayed in visible marketplaces in order to facilitate the price discovery process”. This facility is designed to allow market makers a mechanism to capture active retail flow without quoting visibly, nor granting price improvement to the end client.

Since the dark rules were first implemented, in October 2012, the vast majority of marketplace ‘innovation’ has been aimed at segmenting flow, and granting retail dealers cheaper trading. This has been done to combat the increased marketplace fees that dealers faced post the changes to the dark rules. This segmentation has come at the expense of institutional asset managers. Segmenting of flow has resulted in increased complexity, and a massive increase in information leakage resulting from retail and institutional flows being routed in differing manners. This informational leakage allows for high speed intermediaries to increase trading volumes, resulting in greater revenues for both themselves and the marketplaces catering to their demands. The institutional managers that are responsible for protecting the assets of millions of Canadians, are severely disadvantaged as a result. We again ask, what is the policy objective we are trying to solve?

In the last 24 months we have seen an increase in Canadian institutional trading costs, versus those in the U.S.. Anecdotally we have been awestruck by the number of international asset managers that now claim Canada is the most difficult and expensive market they trade. ***Our insatiable desire to delivery juicy micro term uniformed flow to paying intermediaries, so as to lower the costs for retail dealers, is harming our markets***. This proposal, and other recently approved proposals, violate the very foundational tenants that long made Canada a market structure beacon to the world. Put simply, we have lost the plot. ITG Canada strongly urges the CSA to not only deny this proposal, but to reconsider all the various takes on preferential market maker interactions and the Alpha speed bump. We also reiterate our call to strongly enforce marketplace transparency rules such that all market participants are able to compete on a fair and level playing field.

[1] http://www.osc.gov.on.ca/en/29921.htm

Thank you for allowing us the opportunity to comment on this proposal. As always, we would be more than happy to answer any questions, or expand upon our thoughts as desired.

Sincerely,

Doug Clark
Managing Director,
ITG Canada