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Market Regulation Branch
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and

Matthew Thompson
Chief Compliance Officer
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Re: CX2 Canada ATS: Notice of Initial Operations Report and Request for Feedback

ITG Canada (ITG) would like to thank the CSA for this opportunity to comment on the Chi-X's proposed CX2 marketplace. We appreciate the extensive research and thought that went into the recognition order, and hope our comments will constructively illuminate areas that may require further careful consideration.

ITG is a Global brokerage firm offering leading edge research, trading, cost measurement and trade management tools and services to retail, institutional and brokerage clients. We have long been a top 10 dealer in the Canadian equity space, and are well within the top 20 in the U.S., Western Europe and Asia Pac. Our breadth of tools and markets, coupled with our agency focus, grant us a unique client investor aligned view on market structure matters.

Before we discuss the issue of increased fragmentation in general, we will discuss CX2 in particular.

1) We are both surprised and disappointed that CX2 is offering a ramped up version of broker preferencing.

ITG's concerns around the inherent unfairness of broker preferencing are well documented, and we don't deem it necessary to reiterate them here. We do however feel it worthwhile to point out that the matching methodology CX2 is offering has flaws beyond those contained in a plain vanilla preferencing model. In a plain vanilla model the passive side enjoys the fruits of preferencing at all times. Under the CX2 model the passive side is allowed to choose whether they wish to be preferenced or not. While we appreciate the desire of an "anonymous" order to opt out of preferencing to avoid informational leakage, we are at a loss to construct a reasonable strategy that would opt out of preferencing for non-anonymous orders. The only strategies we can envision are those that use knowledge or routing tables to opt out of preferencing for destinations typically used by institutional orders while opting in for those venues used by retail flow. This is yet another step in the bifurcating of flow that was first allowed for Alpha's IntraSpread product. We continue to believe that such bifurcation of flow is detrimental to natural liquidity consumers, while being extremely profitable for the HFT intermediaries. As such, we are even less favourably disposed to this flavor of preferencing than we are to more plain vanilla versions.

Beyond this concern specific to the CX2 offering, we have further concerns around the notion of marketplaces having multiple books in general.

Given the recent shift in the Canadian market structure, with the Maple Group acquisition of TMX, and TMX's subsequent acquisition of Alpha, we fully appreciate the desire by Chi-X to increase the level of completion in the market, and to expand its offerings to better compete with TMX's growing suite of trading venues. But while we understand Chi-X's desire, we also understand the cost the street must bear in this process as well. At the end of the day we end up with 2 concerns around the proposal – and any similar proposals from other existing Canadian equity markets.

1) We need to address the nature of marketplace liability now, before a new wave of trading venues are allowed to begin operating.

The dealer community in Canada has voiced concern in the past that for profit markets should not be able to insist that captive consumers sign away all legal rights in order to participate. This issue came to a head during the ramp up to TMX Select when a number of Canadian dealers informed the OSC they would not be signing paperwork that unreasonably indemnified the TMX against liabilities resulting from their own error or technology failure. The dealer community is still waiting for this matter to be addressed, and it would seem appropriate to do so before the next wave of trading venues are approved.

Traditionally marketplaces had severally limited liability due to the not for profit co-opertive nature of their being. This no longer makes sense in an era of for profit exchanges, many of which have operating margins that are a multiple of the dealers they service. Not only is a for profit entity better able to absorb losses, but they are also greatly incented to accelerate the rate of system changes and minimize the very system checks that prevent errors in the never ending quest for latency reduction. If the markets are going to continue operating in a perverse setting that incents more changes and fewer checks, they need to wear a sizable portion of the risk such changes invariably accompany. The risk of these changes was never more clear than during the recent Facebook IPO fiasco, when a Nasdaq initiated change resulted in streetwide loses estimated to be upwards of $400 million USD.

We would strongly urge to CSA to address the issue of liability before allowing CX2, or any new markets, to proceed. Such solution should also address the nature of liability for all existing protected Canadian marketplaces. Short of this, we will be asking the CSA to mediate our negotiations with Chi-X around our participation on this market place.

2) Regulators need to address the issue of marketplaces commandeering street development resources.

Over the past 12 months the various marketplaces have made and / or announced a raft of changes that require dealers and vendors to allocate a growing portion of development and testing resources to deal with such changes. These changes include, but are not limited to, data feed changes at TMX, Alpha and Chi-X, the TMX migration to Quantum XA, the migration of Alpha to TMX technology, a variety of non regulatory enforced new order types, the advent of CX2 and the not publically announced introduction of a second trading book at Omega.

The lion's share of cost to develop and test for these new products is worn by the dealers and vendors, not the marketplace in question. By way of example the TMX Quantum XA upgrade has been reasonably estimated by the market structure team at TD Newcrest to cost the dealer and vendor community between $50 and $100 million CAD. This number almost certainly dwarfs the costs the TMX will realize for the upgrade, despite the fact that the upgrade is being forced on the street by TMX, will result in greater uncertainty of order execution and is downloading existing pre-trade checks from the market to the dealer community. We believe that it is high time that the regulators consider the ability of protected marketplaces to force captive consumers to absorb such high costs for changes that are largely unwanted. At the very least we feel the regulators need to manage the flow of such changes, as at the moment there is no process to ensure the entirety of such changes are introduced in a manner that is readily digestable by the street. We witnessed the confussion that occurred in late 2007 and early 2008 when a slew of new markets were introduced in short order, and the vast majority of industry participants were unable to keep up with the rate of change.

In highlighting the issue of these costs, we note that much of the 'innovation' being offered by the various marketplaces is designed with HFT participants in mind, and often times inflicts additionally execution costs on dealers in the form of higher active rates, beyond the increased technology costs.

In looking at this issue we are struck by the beauty of IIROCs recent regulatory fee model change. The central notion behind IIROCs new model was to ensure that those creating the costs were also wearing the costs. We would advocate for a similar model for marketplace changes. If TMX were to wear a sizable portion of the overall cost of the XA migration they would be far better incented to ensure the migration was necessary and done in a manner that is efficient to the street. Likewise we ask, if Chi-X were to wear a sizable portion of the street costs to connect and test for CX2 would they still deem this a worthwhile venture? If not, why is it being allowed to happen on somebody else's dime?

Our request to have Chi-X assume some of the street cost for this new market is bolstered by their surprising and disappointing recent introduction of fees for venture listed market data. Fees that we believe are absurd by any reasonable international standard, and showcase Chi-X's willingness to profit off of the back of captive consumers. These new fees are additional to the

TSX listed real time market data fees that Chi-X charges. We note that according to the CSA's recent comment paper on real time market data fees, Chi-X is currently charging a rate for TSX listed stocks that is more than 2 times higher than the TSX's fees when normalized for volume or value traded, and more than 40 times those of the LSE, ASX or Nasdaq after similar normalization. This of course leads us to ask, will CX2 be allowed to charge separately for real time market data? Will Omega's coming second book be able to charge? What metrics must a market meet before being allowed to levy such fees? (Note we will be responding to the CSA's Data Fee piece separately).

With the TMX having purchased Alpha and limited the competitiveness of the equity trading venue space we find ourselves yet again facing new offerings. It is of vital importance to the robustness of our industry that we react better to this situation the second time around, and avoid the detrimental cost and confusion we experienced with the original wave of new markets 5 years ago. In order to ensure this, we suggest that new protected offerings bear some of the cost they introduce and that the introduction of new markets, data feeds, order types and engine changes be schedules to ensure limited impact on dealer and vendor technology. It is important to remember that when dealer resources are diverted by marketplace offerings they are limited in their ability to build client driven solutions. As such the opportunity cost of such introductions can be massive.

We thank the CSA for this opportunity comment on CX2, and offer our continued guidance around this matter should it be desired.

Sincerely

Doug Clark
Managing Director, Liquidity Research
ITG Canada