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Dear Sirs/Mesdames:

Re: CSA/CIRO Staff Notice 23 – 331 – Request for Feedback on December 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets

Background

BMO Capital Markets¹ (“BMO”) is seeking to respond to the CSA/CIRO Staff Notice 23 – 331 – Request for Feedback on December 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets dated October 19th, 2023.

The SEC is proposing to update the quoting and trading increments on exchanges, in addition to recommending a broader package of reforms designed to address several interrelated aspects of equity market infrastructure. These reforms include harmonizing the increments for trading on and off exchange, accelerating the display of odd lot quotations on securities information processors, redefining the lot sizes in US equities, reducing access fee caps and updating how exchanges are permitted to set pricing tiers.

The US Securities and Exchange Commission proposed changes, if adopted, will impact Canadian equity markets due to the interconnected nature of financial markets. It is hard to predict the effect these changes will have on the US markets and even harder to forecast their impact on Canadian markets. The Canadian markets differ in certain aspects from the US and, therefore, Canadian regulators need to carefully assess what harmonization changes, if any, would be in the best interest of the market.

Variable Minimum Pricing Increments

If the SEC adopts the rule as proposed or a modified version of it that creates a smaller tick size than the Canadian markets should implement the same tick increment for interlisted securities affected by the US rule. Failure to do so would make the Canadian quote less competitive than the US and would drive trading volumes to US markets.

Competitiveness of Canadian exchanges and the market overall, namely in relation to interlisted securities deserves specific attention. Inconsistent minimum pricing increments of such securities may incentivize market participants to trade in the US, should the pricing increments be more attractive

¹ BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Bank N.A. (member FDIC), Bank of Montreal Europe p.l.c, and Bank of Montreal (China) Co. Ltd, the institutional broker dealer business of BMO Capital Markets Corp. (Member FINRA and SIPC) and the agency broker dealer business of Clearpool Execution Services, LLC (Member FINRA and SIPC) in the U.S., and the institutional broker dealer businesses of BMO Nesbitt Burns Inc. (Member Canadian Investment Regulatory Organization and Canadian Investor Protection Fund) in Canada and Asia, Bank of Montreal Europe p.l.c. (authorized and regulated by the Central Bank of Ireland) in Europe and BMO Capital Markets Limited (authorized and regulated by the Financial Conduct Authority) in the UK and Australia. “Nesbitt Burns” is a registered trademark of BMO Nesbitt Burns Inc., used under license. “BMO Capital Markets” is a trademark of Bank of Montreal, used under license. “BMO (M-Bar roundel symbol)” is a registered trademark of Bank of Montreal, used under license. ® Registered trademark of Bank of Montreal in the United States, Canada and elsewhere. ™ Trademark of Bank of Montreal in the United States and Canada. © 2023 BMO Financial Group

there. In a scenario when US marketplaces move to a half tick and Canadian rules remain unchanged, a Canadian order with best execution obligations would likely need to divert trading to US marketplaces when they are quoting tighter markets than are allowed in Canada.

Altering tick sizes for securities not impacted by the possible US rule changes is a separate and distinct issue for consideration. While we believe there is no choice but to follow US regulatory changes that impact tick sizes and access fees in interlisted securities, changes for non interlisted securities are optional. We recommend taking a wait and see approach before considering further changes to quoting and trading increments in Canada outside of the aforementioned interlisted securities.

Canadian regulators should take a measured approach when considering additional changes to minimum quoting and trading increments for non interlisted securities. Industry participants and regulators can both learn through the affected interlisted securities locally as well as other securities in the US affected by the anticipated SEC rule changes. This will allow time for stakeholders to evaluate the costs and benefits of reduced quoting and trading increments.

Reduce Access Fee Caps

Similar to quoting and trading increments, Canada should follow the US if it lowers access fee caps on interlisted securities. It is unclear if the US will lower access fee caps on all securities or only those that have a reduced quoting and trading increment. At a minimum access fees caps on the interlisted securities which are affected by the SEC's rulemaking should be matched in Canada. Should the SEC more broadly reduce access fee caps we believe Canada must follow suit for interlisted names irrespective of their quoting and trading increment. In Canada, we have not observed any negative consequences as a result of the access fee reduction in non interlisted securities and believe there is room for continued reduction in maximum exchange fees broadly for both "maker-taker" as well as "taker-maker" venues.

From an operational perspective, it would reduce complexity if access fees were harmonized with the US, however this should not be a determinative factor. In a scenario when an interlisted security is quoted at the same price in the US and Canada, but access fees will be lower (considering currency exchange rates) in the US, Canadian market participants may be more inclined to consume liquidity on US venues.

Conversely, if rebates were bigger in Canada and they could not be matched in the US, it could potentially create reverse distortions. A potential indirect effect could result in market participants preferencing one market for taking and another market for making. Therefore, some level of harmonization would be helpful to avoid taking and making to be primarily driven by access fee caps across the US and Canadian markets.

We have long supported increased transparency around fees charged by exchanges and agree with the SEC's assessment of how existing exchange pricing tier models can negatively impact market participants' behavior. Pricing that is not determined until month end creates a captive customer who must maintain levels of qualified trading activity or suffer an adverse economic consequence for up to an entire month's trading activity. We are supportive of the approach that would require exchanges to use the prior month's volume when setting volume-based tiers.

Specifically, certainty of costs at the time of trade execution would help dealers make better order routing decisions. Further it would reduce order routing incentives that are based on achieving a threshold to attain a specific fee or rebate.

Conclusion

The SEC proposals for minimum pricing increments, access fees, and transparency of better priced orders is complex, containing interconnected policy updates that will have lasting and broad impacts on the US equity markets. As the proposed changes seek to address inefficiencies in how securities are quoted and traded and how transactions are priced, these changes will inevitably impact Canadian equity markets. Due to the fungible nature of interlisted securities, the US and Canadian markets compete with one another for passive and active order flow. In order for the Canadian markets to remain competitive with their US counterparts, the US regulatory changes should be mimicked for those interlisted securities affected by US policy.

Sincerely,

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