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Re: Proposed Public Interest Rule Amendment and Request For Comments regarding Directed Indication of Interest.

The Canadian Security Traders Association, Inc. (CSTA) is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling, and trading of securities (mainly equities). The CSTA represents over 850 members nationwide and is led by Governors from each of four distinct regions (Toronto, Montreal, Prairies and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world. This letter was prepared by CSTA Trading Issues Committee (TIC) representatives with various areas of market structure expertise. It is important to note that there was no survey sent to our members to determine popular opinion. The views and statements provided below do not necessarily reflect those of all CSTA members or of their employers.

We thank you for the opportunity to comment on the proposed Directed IOI functionality. As proposed, Directed IOIs would operate in a systematic and multilateral fashion that, when combined with MatchNow, would effectively operate as an extension of a marketplace or, as some committee members submit, as an actual marketplace. As the Directed IOI functionality is provided by a registered marketplace, the Fair Access concerns highlighted by regulators are relevant.

Historically, the CSTA TIC has opposed most forms of public market segmentation, including counter-party selection, for fair access reasons. Generally, we believe the Canadian markets cannot support the same degree of marketplace, order, and counterparty segmentation that is observed in the US markets. The Committee was divided on the manner in which this principle should be applied to the proposed facility. We outline the two primary contentions below.



The Committee generally agrees that Directed IOI's would be an exceptionally useful tool for institutional investors. Despite the usefulness of the tool, a majority of the Committee feels this tool would present an example of the tragedy of the commons. The tragedy of the commons is a situation in a shared-resource system where individual users, acting independently according to their own self-interest, behave contrary to the common good of all users by depleting or spoiling the shared resource through their individual action.

In a competitive marketplace, the shared resource is market efficiency (i.e., the benefits everyone receives from liquidity and price discovery). Individual investors, acting in their own self interest, may wish to segment their activity and even to select their own trading counterparty, but any gains from such counterparty selection come at a cost to the overall marketplace.

In an efficient market, prevailing prices reflect all available information and fully satisfy the marginal demand of the most aggressive buyer and the marginal supply of the most aggressive seller, creating an equilibrium at which trades can occur. We acknowledge the concept of market efficiency is somewhat theoretical, but nonetheless it ought to serve as our guiding principle when analyzing market structure proposals. Any market structure change that reduces overall market efficiency ought to be deeply scrutinized.

Directed IOIs, as proposed, would result in an asymmetry of information regarding the prevailing supply and demand for shares and so by design reduce efficiency in pricing.

A minority of the Committee feels that the segmentation contemplated by the Directed IOI functionality as proposed does not unreasonably affect efficient pricing due to its proposed limitation to large sized orders (CAD \$100,000 and greater in gross notional value). This minority maintains that there is already significant asymmetric information exchanged through existing communication tools, written and oral, such that the proposed Directed IOI facility would simply be a more efficient, reliable solution for the same. Verily, the segmentation within the facility would really happen at the communication level rather than the trade matching, marketplace level. Further, as the tool is offered by a regulated entity like the Cboe, rather than an un-regulated entity like a software vendor, it is also more transparent in function and operation to regulators than alternative solutions. There already exist in Canada a handful of single-dealer-provided, vendor-supported directed electronic IOI products. Cboe's proposed facility would in fact make access to such a facility more fair rather than less.

Question 1: In your view, is the proposed Directed IOI functionality consistent with the fair access requirement?

The majority of the CSTA TIC believes that the degree of discrimination offered by directed IOIs is unreasonable. Reasonable discrimination is already well embedded into our market structure, order handling and best execution practices. For example:

- Transparent orders have priority over dark orders.
- Large orders are subject to a different order exposure rule than small orders.
- Orders that provide liquidity are charged different fees than orders that take liquidity.



- Market orders take priority over limit orders at the same price in the closing auctions.

The above examples are all forms of reasonable degrees of discrimination. In each foregoing case, the discrimination is based upon the order characteristics or behavior. We believe those examples of discrimination are reasonable and consistent with the Fair Access requirements (section 5.1 of NI 21 101). Unreasonable discrimination would include discrimination across a class of participants or clients or other more innate characteristics that are not possible to change. For example, one could choose to send a large order or a series of small orders (reasonable). One could choose to either take liquidity or provide liquidity (reasonable). One could choose to send a lit order or dark order (reasonable). But one cannot choose if the order originates from a retail client or an institutional client (unreasonable) or Sponsor A or Sponsor B or Member 1 or Member 2 (unreasonable). Such examples, while not exhaustive, are all examples of unreasonable discrimination practices because the Member, Sponsor or client type is not able to change any of the relevant characteristics.

A minority of the CSTA TIC believe that due to the proposed constraint for Directed IOIs to be limited to large orders (sized C\$100,000 or greater in gross notional value) that the degree of discrimination is, in fact, appropriate and in keeping with current industry practice “upstairs”. Concerns remain that the precedence set by potential approval of this facility would pave the way for further segmentation in the continuous marketplaces at smaller sizes. The entire TIC remain opposed to this notion. But the minority feel that with a tacit acknowledgement of large-size limitation in place, this precedence need not be set.

Question 2: Would users of Directed IOIs have an informational advantage over other market participants since they would have information, including the nature of the counterparties, that is not available to other market participants?

Yes. Directed IOIs are a type of order segmentation where Sponsors, Members, client types etc. can choose to interact with some traders but not others. A Directed IOI segments the market by dividing traders into two categories – those who are informed of supply and demand and those who are less informed. Those who are informed benefit because they have access to additional information. The rest of the traders who are not informed are at an informational disadvantage and the information content embedded in the public quote suffers.

The CSTA TIC believes we all have a collective interest to protect and preserve a Canadian equity market that is fair and efficient for everyone. As proposed, we are divided in our support of Directed IOIs, albeit united in our concern about its precedent for broader market segmentation in continuous order books.

We understand there is no clear rule judging what is and what is not fair access. We have provided two approaches in this letter, but we recognize there may be others. We would be less concerned with fair access if this proposal was strictly limited to bilateral broker/dealer transactions and/or private marketplace interactions.

We would be happy to continue the fair access discussion with the OSC and Cboe. We thank you for the opportunity to comment.