



INVESTMENT DEALERS
ASSOCIATION OF CANADA

ASSOCIATION CANADIENNE DES
COURTIERS EN VALEURS MOBILIÈRES

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PRESIDENT AND CHIEF EXECUTIVE OFFICER

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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario
M5H 3S8

And

Anne-Marie Beaudoin, Directrice du secrétariat
Autorité des marchés financiers
Tour de la Bourse
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C.P. 246, 22e étage
Montréal, Québec H4Z 1G3

Re: IDA Comments on CSA Discussion Paper 23-403 – Market Structure Developments and Trade-Through Obligations

I am pleased to provide, on behalf of the Investment Dealers Association of Canada (IDA), our comments regarding the Canadian Securities Administrators Discussion Paper 23-403 - Market Structure Developments and Trade-Through Obligations (Discussion Paper).

The IDA is the national self-regulatory organization and representative of the securities industry. Our Members include more than 200 investment dealers who play an essential role in the



Canadian economy. Our mandate is to protect investors and enhance the efficiency and competitiveness of the Canadian capital markets.

The Need for Market Wide Trade-Through Protection

The IDA is supportive of the efforts being made to better understand issues surrounding trade-through obligations to ensure that there is an appropriate regulatory framework in place.

Market Regulation Services Inc. (RS) introduced the Universal Market Integrity Rules (UMIR) as a way to ensure that the Canadian equity trading market was “marketplace neutral.” However, as the Canadian markets have evolved and new marketplaces have emerged, UMIR no longer appears to ensure neutral application.

Currently, non-dealer market participants, defined as Access Persons under UMIR are not subject to trade-through obligations. The end result is UMIR does not ensure neutral application to investors as the requirement to honour better priced orders does not extend to these Access Persons. The orders of small retail investors are typically orders that would be bypassed in the event that trade-throughs are permitted. Small retail orders are critical to the price discovery process and to the efficiency of equity markets. The IDA supports a comprehensive empirical study that quantifies the advantages of the trade-through rule, in terms of market liquidity and efficiency. This type of study would be very useful to assist policy-makers in evaluating the liquidity-efficiency argument and deciding on an appropriate course of action.

The IDA is supportive of the proposal put forth by RS, which consists of an across-the-board trade-through obligation which will provide a level playing field for order execution and which will provide protection to the small retail investors. Ensuring that investors are treated alike is key and investors large and small should be assured that their orders to buy or sell a security will be executed before inferior priced orders. Inequitable treatment creates the perception of unfairness among investors and this can damage the overall confidence that investors have in the market. The best price rule is currently in place for trades on stock exchanges and upstairs dealer markets and with the emergence of new marketplaces it would be unfair and unjust for this basic concept not to apply. New competitive markets in Canada are welcomed, but not to the extent that they exploit regulatory gaps through choice of trading venues as this would result in an unfair competitive advantage. As such, trade-through protection is needed where there are multiple marketplaces trading the same securities as failing to impose this invites regulatory arbitrage.

The IDA does not think that the trade-through obligation should be limited to exchange traded securities. The trade-through obligation is one that should apply across all markets including debt markets and derivative markets. Implementing a trade-through rule for debt markets and derivatives markets will be complex because these securities trade in multiple over-the-counter dealer markets. These markets are not linked electronically to route orders and ensure best price execution. An effective transparency system such as CanPX that links these markets would provide a benchmark for dealers to offer a fair, if not the best price prevailing in the markets to



their clients. A decision to extend the trade-through obligation across equity markets may however set an important precedent for other markets to address any best price or best execution concerns. The concept that better priced orders should not be bypassed is a basic principal that should be followed in all markets.

Exceptions to the General Rule

It should be noted that exceptions do exist to the general rule that better priced orders should be executed first. Carve outs from the general trade-through obligation are required for certain types of orders. For instance, the IDA agrees with RS that only better priced orders that are visible to marketplace participants should be included in the general rule. Likewise, certain special term orders should be exempt as is the case where certain conditions are attached that cannot be met. With respect to large block trades, the IDA is of the view that no exception should be permitted as this has not been the case in the past. Large block trades should be subject to the same trade-through obligations as small orders. The IDA submits that the determination of what should and should not be exempt should be left to RS to consider.

Balancing Regulation and Competition

The Discussion Paper questions whether the trade-through obligation will impede competition or stifle innovation by forcing new marketplaces to change existing business practice and adopt technology in order to comply with the trade-through obligation. This was an important point of contention in the United States where Alternative Trading Systems (ATS) complained that the trade-through requirements would damage their businesses. Canada is in a very different position in this respect since at this point in time ATSs have only recently begun operating in our marketplace. The trade-through rule has prevailed in domestic equity markets even before the ATS rules were introduced, with dealers adapting the necessary technology and practices to ensure that their obligations were met. Furthermore, new ATSs entering the marketplace are well aware of the existing trade-through prohibitions and should therefore adapt the necessary technology and practices to conform to the rules when they begin operating. By doing so, they will not be at a competitive disadvantage in the marketplace and the technology costs will likely not be significant. As previously stated, an important consideration in this debate is that innovation and competition should not exploit regulatory gaps through choice of trading venues. The focus should be directed at new ideas that increase the choices available, promote investor confidence, increase market efficiency and fairness and enhance the integrity of the markets but not to the extent that they compromise investor protection.

Impact of Alternative Methods of Implementing Trade-Through Obligations

The IDA supports the position that the trade-through obligation is one that all marketplace participants owe to the market. This is not a fiduciary duty owed by a dealer to its clients but rather a duty owed to the market generally by all market participants. This position remains



consistent with the view taken historically when separate exchanges existed in Canada. Historically, each exchange had requirements which prevented members from trading through better-priced orders and this has not changed with the realignment of the exchanges. The obligation exists to protect orders in the public market.

The responsibility for ensuring compliance with the obligation could rest with either the marketplace or the market participant and there are pros and cons to each position as outlined in the Discussion Paper. For instance, the United States has imposed this obligation on the marketplace. While the discussion on trade-throughs should look at other jurisdictions for guidance it still needs to recognize that our markets are different. Currently, there are very few marketplaces that trade equity securities in Canada other than the new ATS start-ups, the recognized Canadian stock exchanges and the dealer over-the-counter upstairs markets. The latter two markets already conform to the trade-through rule. As such, it makes sense that new marketplaces as they emerge are subject to the same obligation and are required to comply with the trade-through rule. Issues that still need to be considered if this obligation is imposed on the marketplace is whether it would have a negative effect on the development of new marketplaces as the onus to build systems would likely fall to the marketplaces rather than to the participants. Likewise, if this option was implemented and it required electronic connections between marketplaces, market participants may be less motivated to join new marketplaces since doing so will not be necessary to access those orders.


With respect to the debt market, since there is a constellation of over-the-counter markets and an absence of electronic linkage, it makes sense to impose the trade-through obligation on the dealer rather than the marketplace. As stated earlier, a trade-through obligation is more complicated to introduce in the debt market and as such is in need of further discussion.

Conclusion

In conclusion, we believe that the Discussion Paper raises a number of very important issues that are in need of further debate. The CSA should above all else ensure that a level playing field exists with respect to order execution regardless of the market to which the order is entered, so that investors can be confident that all orders will be treated fairly and equally.

Thank you for this opportunity to comment on the Discussion Paper.

Yours truly,



Joseph J. Oliver
President and Chief Executive Officer