



*Buy-Side Investment Management Association Inc.*

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January 10, 2011

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

c/o John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West, Suite 1903, Box 55  
Toronto, Ontario M5H 3S8  
email: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

-and-

Madame Anne Marie Beaudoin  
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-and-

James Twiss, Vice President, Market Regulation Policy  
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Dear Sirs and Madams:

**Re: Joint CSA/IIROC – Position Paper 23-405  
Dark Liquidity in the Canadian Market**

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The Buy Side Investment Management Association (“BIMA”) is pleased to make this submission on Position Paper 23-405 - Dark Liquidity in the Canadian Market

BIMA’s was founded by, and represents, investment buyers from Canadian financial firms. Our members include bankers, corporate investors, fund managers, government investors and pension managers. Our mission is to provide our members with a community where Canadian buy-side traders and investors can connect with their peers, exchange ideas and information and learn ways to enhance performance.

We thank you for seeking consultation and input from industry professionals as you engage in policy formation. We applaud your efforts and hope that there continues to be open and mutually beneficial dialogue between regulators and industry in this area.

Our high level concerns and comments can be summarized as follows:

In general, BIMA members believe that dark liquidity / dark order types are important to a well functioning marketplace. We agree with the view expressed in your paper that Dark Orders can help to minimize market impact and thus can assist a buy-side manager in discharging their fiduciary obligations.

We understand the regulatory concern that dark pools and dark order types may impede price discovery. Our members do not believe that the availability of dark orders will significantly impact the price discovery process in Canada. If institutional investors can enter orders with less fear of information leakage, then the liquidity that exists on the desks and blotters of buy-side traders is more likely to be made available. The availability of dark order types, while having little negative effect on price discovery, will discourage further internalization, which in turn enhances the overall quality and depth of the Canadian markets.

Below, we respond to the views of regulatory staff as expressed in the Position Paper.

### **Minimum Order Size**

Our members would generally prefer that regulators not mandate a minimum size. We consider that the marketplaces themselves should establish these limits rather than the regulator. We believe that this approach will be more flexible and responsive to industry since a meaningful minimum size will differ significantly depending on the issuer, and a “one size fits all” rule will result in anomalies. For example, 5,000 shares of Bombardier (BBD.B), with an average daily volume of well over 1,000,000 shares does not compare with 5,000 shares of Richelieu Hardware (RCH), with an average daily volume of less than 20,000 shares<sup>1</sup>. Being closer to the markets and the issuers, the trading venues, we submit, are in a better position than regulators to make or amend rules on appropriate order sizes.

<sup>1</sup> According to TSX data, for the 30 days ended January 10, 2011, the average volume on TSX for BBD.B was 5,630,413, with a low of 1,745,526, and a high of 14,871,389; for RCH, average trading volume was 11,259 shares, with a low of 391 shares and a high of 56,073 shares (Christmas Eve trading excluded from lows). Using January 10, 2011 closing prices, 5,000 shares of BBD.B at \$5.24 totaled \$26,200 and 5,000 shares of RCH at \$30.75 totaled \$153,750. There are issuers whose shares trade at higher prices per share including the major bank stocks. To take an even more extreme example, 5,000 shares of Fairfax Financial at \$410 per share works out to \$2,050,000.



Some of our members believe that there ought to be no restrictions on order size. As algorithmic and black box trading have increasingly dominated the marketplace, with computer driven programs that attempt to detect or anticipate large orders, it becomes more difficult for institutional traders who cannot react and enter their orders as quickly as a machine. Those members believe that allowing small active orders (less than or equal to 100 shares) to interact with liquidity in dark pools will provide information to opportunistic traders that may otherwise not be available. The experience of our members is that the opportunistic traders impede the ability to trade blocks while minimizing market impact. As a result, requiring smaller orders to be visible has a negative impact on the ability to execute trades, particularly for limit orders.

If there is to be a minimum order size, then our members advocate that any minimum apply to both passive resting orders as well as the active orders. Requiring both passive and active orders to meet a minimum size will help to ameliorate the order anticipation arbitrage, and is consistent with the purpose of dark pools as expressed in your Position Paper.

### **Price Improvement**

The Position Paper would permit two dark orders to execute at NBBO (without price improvement), so long as both orders meet the minimum size. In all other circumstances, “meaningful price improvement” would be required. Subject to our comments on minimum order size and sub-penny pricing and what is meant by “meaningful”, our members have no objection to this proposal. We do not believe it is necessary that every single dark order, without exception, offer price improvement.

### **Execution Priority**

The Position Paper would have visible orders execute before dark orders at the same price on the same marketplace, subject to two dark orders at the same price that meet the minimum size being able to execute at that price. The rationale is that although visible liquidity is to be encouraged whenever possible, and visible orders given priority over dark orders, there should be an exception where dark orders at the same price meet the minimum size threshold.

Our members agree with the principle that visible orders should enjoy priority over dark orders in the same trading venue. We agree of course that the more visible orders there are, the better. We are also in favour of a large order being able to match a contra large order at NBBO without first having to clear the visible orders. This is consistent with the underlying purpose of dark order types: to be able to trade significant volumes at one time while minimizing market impact and information leakage.

### **The Meaning of “Meaningful”**

The Position Paper proposes to define “meaningful” price improvement as a minimum of one trading increment over NBBO, except where the NBBO is already at the minimum tick. In that case, it would be at the mid-point of the spread.

Our members generally agree that sub-penny pricing does not confer any real benefits. To the contrary, sub-penny pricing facilitates gaming, adding unnecessary cost and complexity to the trading process.

Furthermore, we believe that meaningful price improvement must also be tied to volume. Price improvement in a very small order does not appreciably contribute to price discovery, whereas a trade of a larger number of shares does. If regulators are inclined to the position that dark orders must offer “meaningful price improvement”, there must be both a price increase component as well as a minimum size component. We therefore reiterate our view that any minimum size requirement, whether imposed by regulators or by the trading venues, apply to both active and passive orders. In this way, we can ensure that price improvement is real and not meaningless.

### **Concluding Remarks**

We would be pleased to expand on the above at your request. If you have any questions regarding our submission, please do not hesitate to contact Milos Vukovic at [milos.vukovic@rbc.com](mailto:milos.vukovic@rbc.com) or Ms Carol-Ann Banahan at [cbanahan@phn.com](mailto:cbanahan@phn.com).

Yours truly,

BUY SIDE INVESTMENT MANAGEMENT ASSOCIATION

*Buy Side Investment Management Association*

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