INVESTMENT TECHNOLOGY GROUP

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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Autorité des marches Financiers
Manitoba Securities Commission
Ontario Securities Commission
New Brunswick Securities Office
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Nunavut
Registrar of Securities, Yukon Territory

Attention:

John Stevenson
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, ON M5H 3S8

Madame Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

James Twiss – Vice President, Market Regulation Policy, and
Kevin McCoy – Senior Policy Analyst, Market Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 1600, 121 King Street West
Toronto, ON M5H 3T9

Dear Mme. Beaudoin & Messrs. Stevenson, Twiss and McCoy:

ITG Canada is pleased to have the opportunity to comment on the Joint CSA/IIROC Position Paper, 23-405, on Dark Liquidity in the Canadian Market. ITG Canada is a subsidiary of ITG Inc., a specialized independent brokerage and financial technology firm. Globally, ITG Inc.

partners with asset managers to provide innovative solutions spanning the investment continuum. A leader in electronic trading since launching POSIT® in 1987, ITG's integrated approach now includes a range of products from portfolio management and pre-trade analysis to trade execution and post-trade evaluation. Asset managers rely on ITG's independence, experience, and agility to help mitigate risk, improve performance and navigate increasingly complex markets.

We have read the position paper, 23-405, on Dark Liquidity and are supportive of the objectives that the CSA and IIROC have set out for their analysis of the issues related to Dark Liquidity in Canada and the impact each of these issues has against the standards of liquidity, transparency, price discovery, fairness and integrity. Further, we fully support that Canadian regulators have established a framework in Canada that is consistent with the principles relating to dark liquidity which were proposed by the Technical Committee of the International Organization of Securities Commissions (IOSCO).

The topic of dark pools has been the subject of much debate and discussion around the globe. Regulators in many jurisdictions have studied the issues related to dark liquidity. Canadian regulators, and their global counterparts in CESR, IOSCO, ASIC and the SEC have all published reports or proposals related to dark liquidity which focus on the impact of dark trading on the price discovery mechanism and overall market integrity and quality. It is important that regulators consider these issues and take the time to weigh comments from all participants as well as review the current data that exists regarding dark liquidity.

It is also important to remember that, although dark trading has been the subject of huge debate in the industry and in the press, it is still a relatively small portion of the trading liquidity across our markets. In the U.S., where dark trading is more developed, dark pools account for approximately 10-12% of total market share; however, a substantial portion of this volume represents broker-sponsored internalization pools not public, neutral dark marketplaces[1]. Globally, estimates for dark trading are 4% in Europe; less than 1% percent in Asia and less than 2% in Canada[2].

ITG operates dark crossing systems around the globe under the Posit brand. In Canada, as the owner of TriAct Canada Marketplace, ITG operates the MATCH Now system, currently the largest dark pool in Canada (in Dec, 2010, MATCH Now represented 1.65% of the 1.8% total Canadian volume traded in Dark Pools). ITG has done significant research regarding the impact that dark pools have on trading liquidity, market integrity and the benefits of dark trading for investors. We are in a unique position to comment on the CSA/IIROC Position paper and to provide factual statistical research to support our views.

In a recent article[3] entitled "Are We Missing the Evidence in the Global Dark Pool Debate?, Ian Domowitz[4], Managing Director for ITG, discussed the current research that has been

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[1] See Rosenblatt Securities Inc.: *Let there Be Light, Rosenblatt Monthly Dark Pool Liquidity Tracker*

[2] ITG Canada *Light and Dark Markets Report*, December 2010 (see attached Appendix A).

[3] ITG Insights Newsletter, Volume One, Issue Ten, Dec. 8, 2010: *Are We Missing the Evidence in the Global Dark Pool Debate?*

[4] Ian Domowitz is Managing Director of ITG Inc., responsible for ITG's networking, research and analytical products. He previously served as Smeal Professor of Finance at Pennsylvania State University and has held positions with Northwestern's Kellogg School of Management, Columbia University, The CFTC, IMF and the World Bank.

done on dark pool trading. His conclusion was that there was no empirical evidence to support the idea that dark pool trading has a detrimental effect on market quality and execution performance. In his review, Domowitz cited a number of studies, all of which found no evidence of a detrimental effect on market quality. The most comprehensive work cited was done for SIFMA by three academic researchers[5] at Ohio State University and contained data on 4,482 stocks trading in eleven dark pools in the U.S. representing an average of 4.5% of consolidated U.S. volume, or half the dark share in the U.S.. The analysis found that "***Higher dark pool activity is associated with lower quoted spreads, lower effective spreads[6], small price impact and low short-term volatility. Securities with large amounts of dark pool trading are characterized by greater quoted depth in the lit markets, and exhibit smaller order imbalances relative to share volume than stocks for which dark pool trading is minimal***."[7]

Further evidence is provided by ITG's own research, two large-scale studies in the U.S. and Europe. These studies found that, in the U.S., transaction costs in lit markets are three times those for dark liquidity aggregation while in Europe, execution costs in an MTF are 43 percent higher than in a dark venue. Domowitz's overall conclusion, based on the independent studies and ITG's research: "***It is too early to conclude that dark pool activity contributes to market quality in a causal sense. On the other hand, there is nothing to suggest the opposite. No empirical evidence based on dark pool data supports the notion that dark pool trading has a detrimental effect on quality of markets and executions***."[8]

In addition, ITG Canada has done specific research related to trading in MATCH Now. The question of adverse selection in accessing dark pool liquidity is a primary concern for institutional traders (a trader would consider himself/herself to be 'adversely selected' when the stock moves in his/her favour immediately after executing a block). TCA analysis of ITG's liquidity-providing block trades for Q1-Q3 2010 indicates that there is no evidence of adverse selection in MATCH Now. [9]

Given the relatively small percentage of current volumes trading in dark pools in Canada, and the fact that there is no evidence to support the concern that dark pools have a negative impact on market quality, we believe that there is no strong argument for any significant regulatory changes in the current Canadian framework. Indeed, in Canada, we have far greater transparency around dark pool trading than exists in any other jurisdiction. Many regulators are now proposing the standards that have existed in Canada since the ATS rules were formed in 2001. We would also suggest that any regulatory proposals regarding dark liquidity must be considered as part of the overall regulatory framework and should include the rules governing internalization of client order flow, broker preferencing as well

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[5] S. Buti, B. Rindi & I.M. Werner, 2010, Diving into Dark Pools, Working paper, Fisher College of Business, Ohio State University.
[6] Effective spreads are the (signed, positive or negative) difference between trade price and the bid-ask midpoint prevailing at the time of the order submission. U.S. regulators require marketplaces to report effective spreads under Rule 605.
[7] ITG Insights Newsletter, see supra note 2.
[8] ITG Insights Newsletter, see supra note 2.

[9] From forthcoming report to be released in January 2011: ITG's Trading Performance in MATCH Now

as IOIs. To consider any of these issues in isolation does not fully address the complexity of the trading environment in which participants operate and may run the risk of creating "unintended consequences" for market quality and integrity. It is not yet clear that there is a significant problem to be solved. These proposals may create regulatory arbitrage for our inter-listed issues and drive trading flow in inter-listed issues south of the border. Some Canadian dealers have already suggested the possibility of selling or routing their inter-listed flow to U.S. dark and crossing markets.

The following pages provide our specific responses to each of the recommendations set out by the Joint CSA/IIROC Position Paper.

CSA/IIROC Staff Recommendation #1: "The only exemption to pre-trade transparency should be for orders that meet a minimum size threshold."

We agree with the CSA/IIROC position that orders entered into the marketplace should generally be transparent to the public and subject to pre-trade transparency requirement as per NI 21-101. The requirement for exposure of limit orders is integral to the price discovery process and those orders should receive priority for their commitment to the marketplace in establishing price.

However, we do not believe that dark orders should only be exempted from pre-trade transparency when they meet or exceed a minimum size threshold. We believe that this restriction is harmful to achieving Best Execution in a number of ways:

- It is the duty and obligation of the trader handling an order to determine how best to manage that order to achieve Best Execution for the client. This management may include a variety of trade strategies and venues, including dark pools or dark orders in a transparent market. If the trader managing the order chooses to incrementally piece out the order in a dark book, then he/she should have that discretion. To require that passive orders only be placed in a dark book when they are of a particular size, will impede the trader's ability to use the best judgment possible on how to achieve Best Execution. In many dark books, including MATCH Now, a trader can choose to implement a minimum size requirement thus ensuring that the order does not interact with many small orders and potentially be subject to information leakage. It is critical that Best Execution be determined by the trader's knowledge, experience and expertise - <u>not by regulatory mandate. Imposing a minimum size threshold would effectively tell the trader how to manage the order and would legislate away the trader's ability to use their judgement in achieving Best Execution.</u>

- Frequently, a buy-side or sell-side trader managing a large block will choose to manage that order through the use of an algorithm. By definition, the algorithm will piece out a large order in smaller increments based on a pre-defined strategy in an effort to minimize market impact and also seek liquidity. These algorithms would be extremely hampered in their ability to manage an order if passive orders could only be placed in a dark pool when the order was above a specific threshold size. It is important to note that these very large orders represent investment decisions on behalf on many, many small investors (e.g. pension funds, mutual funds). In our experience, the use of strategies such as algorithms have enabled us to trade orders of very significant size (e.g. over $1 billion) with minimal market impact, and more importantly no information leakage on behalf of these investors.

- Although dark orders/pools were originally intended to facilitate matching large blocks in order to minimize market impact, a number of interesting hybrid models have emerged which have benefits for both large institutional and small retail investors. Indeed, in Canada, MATCH Now has offered a model which, for the first time, enabled retail and institutional order flows to interact in a meaningful way. Prior to the advent of electronic trading, large block orders were most often "matched" in the upstairs market and did not interact with the predominantly retail order flow which traded on the floor of the exchange. When traders place passive orders in MATCH Now and have anonymity, they are able to protect these orders while the "streaming" liquidity on the active side has the opportunity to interact with passive orders – and both sides of the trade receive price improvement. Surely, this is a win-win for all parties involved in the trade. Dark pools have evolved to offer competitive solutions and choice in a multiple market environment.

- A significant amount of trading in Canadian issues is done on an inter-listed basis between Canada and the U.S. We have some concern that the implementation of a minimum threshold for dark pools in Canada would reduce the amount of trading done in dark pools in Canada and lead to regulatory arbitrage, resulting in further flow of inter-listed trades to the U.S.

- Given the small average trade size today across all markets, an arbitrary minimum size threshold of 50 board lots is not justified and would be prohibitive to the functioning of dark pools. Choosing a single minimum threshold assumes that all stocks have similar liquidity characteristics and they do not. A 50 board lot order may be relatively small for a very liquid name while it might represent a very large order for an illiquid stock.

- ITG Canada has done a significant amount of research on Canadian market structure and the changes in trading patterns. Based on the latest ITG Canada Market Microstructure Report[10], the current average trade size across all light and dark markets is 400 shares. In MATCH Now, the current average trade size is slightly lower (approximately 320 shares with a median of 100 shares) reflecting the fact that many passive orders are placed by algorithms and are being matched to retail flow on the active side.

[10] ITG Canada Canadian Market Microstructure Review, Third Quarter, 2010

CSA/IIROC Staff Recommendation #2: Two dark orders meeting the minimum size exemption should be able to execute at the NBBO. Meaningful price improvement should be required in all other circumstances, including all executions with orders not specifically marked in a manner indicating they are utilizing the minimum size exemption.

For the reasons outlined above, we do not believe that there should be a minimum size threshold for dark liquidity. We would also argue that any visible order on a marketplace should execute before a dark order at the same price. We believe that this approach is much more consistent with current UMIR rules regarding order protection. This is also consistent with the next staff recommendation regarding visible orders and priority.

CSA/IIROC Staff Recommendation #3: Visible orders on a marketplace should execute before dark orders at the same price on the same marketplace. However, an exception could be made where two dark orders meeting the minimum size threshold can be executed at that price.

Market participants in Canada have long had the benefit of trading in an auction market which is supported by a highly visible electronic book. Indeed, the UMIR Order Exposure rules have required for some time that orders under 50 board lots be placed in a transparent market. Participants who make a commitment to the price discovery process by placing their order in a transparent market are providing a benefit to the marketplace. We are therefore in agreement that visible orders should be rewarded by being given priority.

Regarding the second part of the recommendation, that dark orders over the minimum size threshold could be executed at the NBBO, we would refer to consistency with our answer on the previous recommendation; i.e., there should be no minimum threshold and therefore two dark orders should not be allowed to cross on the NBBO.

CSA/IIROC Staff Recommendation #4: Meaningful price improvement means that the price is improved over the NBBO by a minimum of one trading increment as defined in UMIR, except where the NBBO spread is already at the minimum tick. In this case, meaningful price improvement would be at the mid-point of the spread.

We understand the concerns that the regulators have expressed regarding sub-penny quote jumping and the related technology costs. We agree that price improvement should be meaningful. Very small price improvement increments which are used to quote jump and circumvent UMIR order exposure rules do not contribute to the overall integrity of the markets. Meaningful price improvements should and can constitute one of the key benefits of trading in dark pools.

The MATCH Now system established an 80/20 split when launched. This was intended to complement the mid-point matching model and to encourage passive orders to be placed in the book. These passive orders can potentially match other passive orders in the book at mid-point or match streaming liquidity with the 80/20 split and thus increase the amount of liquidity available to be executed with price improvement. We believe that this model has been accepted by the marketplace and provides the benefit of price improvement to all participants.

We would also like to point out, that to fully understand this issue, regulators should look at the combined effect of the price model and the associated costs; i.e., the price at which the trade is executed plus/minus the trade cost and any rebates. Meaningful price improvement must be evaluated in the context of strategies that aggregate liquidity and in effect provide liquidity from market making activities. The average p/l is estimated at 5-12 mils and rebates are 30mils. A 20 mil price improvement has the impact of eliminating typical rebate arbitrage and gaming strategies. Further analysis needs to be done on maker/taker fee structures and price improvement in order to understand the overall impact on liquidity in the market place.

Summary

The issues addressed in the CSA/IIROC proposals are important ones and we appreciate the opportunity to share our views with the CSA and IIROC in helping you form your decision. We appreciate that a great deal of time and effort has gone into the consultation process and believe that this process is critical to achieving the best framework for our marketplaces in an increasingly complex environment. We would like to make these final observations:

- Dark pools currently represent less than 2% of market share in this country. While it is important to create a solid framework that protects market integrity, we do not believe that substantial regulatory changes are required at this time.
- We would further argue that the factual evidence indicates that dark trading actually enhances liquidity and supports market integrity and the price discovery mechanism. At the very least, there is no empirical evidence to the contrary.
- Finally, we believe that the issue of dark liquidity must be considered in light of several other related issues and that the structural framework cannot be determined in a piecemeal manner. If regulators are concerned about internalization, then the regulations around dark liquidity should also take into account the rules governing internalization, broker preferencing and IOIs. We will only be able to establish the best possible framework for our market, when all of these intersecting factors have been considered and the issues related to each taken into account.

Thank you for your attention to our views. In closing, ITG Canada believes that Dark Pools offer significant benefits for both retail and institutional investors: improved liquidity, reduced transaction costs, price improvement, reduced market impact and valid, alternative choices to existing transparent auction markets.

Regards,

Nicholas Thadaney
Chief Executive Officer
ITG Canada Corp.

CC: Mats Goebels
Managing Director, General Counsel and Secretary
ITG Inc.

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APPENDIX A

ITG CANADA
Light & Dark Markets Report
December 2010

Stats for: 12/01/2010-12/31/2010	% of Total Volume	% of Canadian Volume	Total Volume	Total Value	Trades	Block^ Vol %Total
TSX`	48.36%	64.18%	9,456,655,096	$124,906,374,710	15,732,615	15.4%
Alpha`	16.59%	22.02%	3,244,703,377	$36,531,164,129	5,399,412	16.0%
Chi-X`	5.20%	6.90%	1,016,985,600	$16,819,174,101	4,018,655	n/a
Omega*	1.06%	1.40%	206,809,200	$2,419,724,534	589,847	n/a
Pure`	2.77%	3.68%	541,897,555	$6,235,734,536	803,140	35.1%
Liquidnet*	0.12%	0.16%	23,721,600	$549,305,618	351	n/a
MATCH Now`	1.25%	1.65%	243,541,800	$4,613,171,037	782,527	n/a
Inter-listed U.S.	24.65%		4,819,725,976			

ATS Mkt Share (% Total Vol. x Interlisted Vol) = 35.82%

ATS xBlock Mkt Share (% Total xBlock^ Vol. x Interlisted Vol) = 36.33%

Non-TSX Mkt Share (% Total Vol including Interlisted vol) = 51.64%

^ **'Upstairs'** block crosses at 10,000 shares and $100,000 or more.

Excludes .DB, .U, .NT, .WT, .PR, and Venture and CNQ traded securities `Source ITS *Source Reuters.

Inter-listed U.S. volume does not include OTC traded securities or pink sheets.