

June 14, 2011

By e-mail

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British Columbia Securities Commission  
Manitoba Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Superintendent of Securities of Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Nova Scotia Securities Commission  
Superintendent of Securities, Nunavut  
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Re: Liquidnet Canada Inc. - Comment Letter on Recent CSA Proposed Amendments to National Instrument 21-101, Marketplace Operation, and 23-101, Trading Rules

Ladies and Gentlemen,

Liquidnet Canada Inc. (Liquidnet) appreciates the opportunity to submit this comment letter on the proposed amendments to National Instrument 21-101, Marketplace Operation, and 23-101, Trading Rules (the Rule Proposals) recently published by the Canadian Securities Administrators (CSA). The Rule Proposals address many of the topics discussed in Position Paper 23-405 (the Position Paper), jointly issued by the CSA and the Investment Industry Regulatory Organization of Canada (IIROC).

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Liquidnet and its global affiliates operate block crossing systems for institutional investors in 39 countries on 5 continents. Our average execution size for Canadian securities is 86,296 shares,<sup>1</sup> which is 151 times larger than the average execution size on the Toronto Stock Exchange.<sup>2</sup>

In the United States, according to publicly available data that broker-dealers are required to file with the Securities and Exchange Commission, Liquidnet provides a level of price improvement that is 18 times greater than the industry average.<sup>3</sup> While similar execution quality data is not available for Canada, it would be safe to assume, based on the fact that Liquidnet executes 90% of our trades in Canadian securities at the mid-point,<sup>4</sup> that Liquidnet similarly provides price improvement for Canadian securities that is multiple times greater than the industry average.

In addition to price improvement, Liquidnet provides value through reduced market impact. For the third year in a row, Liquidnet was ranked #1 in execution quality across all institutional brokers.<sup>5</sup>

The benefits that Liquidnet provides accrue to the majority of Canadian citizens through their investments in mutual funds, pension plans and other mutual investments. In addition to representing millions of Canadian citizens, our institutional customers, as long-term investors, represent the most reliable and important source of capital for Canadian corporations.

We are providing as **Exhibit 1** comments from buy-side institutions globally on the benefits of block crossing systems like Liquidnet that reduce market impact costs for trading large block orders. Pages 26 through 32 of **Exhibit 1** contain numerous quotes from Canadian institutions on the value of systems like Liquidnet.

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Our primary concern in evaluating the Rule Proposals is the need to ensure that institutional investors who trade on behalf of these millions of Canadian citizens have the flexibility to execute large orders in the most efficient manner. In many cases, well-meaning rule proposals that seek to treat everyone “equally” can end up making it easier for high-frequency traders and other market intermediaries to take advantage of buy-side institutional investors who trade on behalf of long-term investors. Even when a regulation sounds “fair,” if it increases trading costs for millions of Canadian citizens and makes it more difficult for them to trade blocks, it is not a good idea.

The Canadian regulators have indicated in their written position papers<sup>6</sup> and current rules<sup>7</sup> and in their conversations with representatives of Liquidnet that they understand the specific challenge that

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<sup>1</sup> Liquidnet data, Q1 2011.

<sup>2</sup> TSX data, Q1 2011 [http://www.iroc.ca/English/Documents/MarketplaceStatisticsReport\\_en.pdf](http://www.iroc.ca/English/Documents/MarketplaceStatisticsReport_en.pdf) (accessed June 14, 2011). This number includes off-exchange matched crosses, which are not differentiated in TSX reporting.

<sup>3</sup> Rule 605 data compiled by Thomson Transaction Analytics Reports, July to December 2010.

<sup>4</sup> Liquidnet data, Q1 2011.

<sup>5</sup> “Tradewatch,” *Pensions & Investments*, March 7, 2011, <http://www.pionline.com/article/20110307/CHART1/110309936> (accessed June 14, 2011).



institutions face in executing block orders and the need for specific provisions to address this challenge. Liquidnet is concerned that the current proposal on IOIs, read literally, could restrict our existing block negotiation business, notwithstanding the price improvement and market impact savings that we provide to institutions. From our review of the written position papers and our discussions with regulators, we do not believe that this is the CSA's intent. In our comment letter we propose specific modifications to the Rule Proposals that we believe would address our concerns without impeding the overall objectives of the Rule Proposals.

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We restrict our comments to the proposals in Section 2, entitled "[T]ransparency requirements applicable to marketplaces dealing in exchange-traded securities."

### ***Minimum order size requirement for dark orders***

We appreciate the CSA's acknowledgment in the CSA Notice that "... there has been limited activity in dark pools and no evidence that dark liquidity has had a negative impact on the Canadian capital markets."<sup>8</sup> Based on the CSA's acknowledgment and other factors that we have discussed in detail in our previous comment letter,<sup>9</sup> we do not support the proposal for a minimum order size requirement for dark orders.

While we do not support such a proposal, we note that from a business standpoint such a proposal would not be a concern for us as long as the minimum order size threshold were set in a manner that protected large institutional orders. In our previous comment letter we indicated our position that 50 trading units would be a reasonable threshold for a minimum order size exemption. We also support an exemption from the minimum order size requirement where significant price improvement is provided, as it should be permitted (and, in fact, encouraged) to provide significant price improvement for retail customer orders.

### ***Minimum order size requirement for dark orders - residuals***

With regard to the proposed minimum order size requirement, we support the view expressed by the CSA and IIROC in the Position Paper that, "... if a Dark Order meeting the minimum size threshold receives a partial fill which results in the remaining balance being less than the size threshold, that order should be able to continue to remain dark until cancelled or fully executed."

<sup>6</sup> See, for example, Position Paper 23-405, Dark Liquidity in the Canadian Market, jointly issued by the CSA and IIROC, November 19, 2010, (2010) 33 OSCB 10764, [http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa\\_20101119\\_23-405\\_dark-liquidity.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20101119_23-405_dark-liquidity.pdf) (accessed June 14, 2011), at pp. 10766 and 10770.

<sup>7</sup> See, for example, Rule 6.3 of the Universal Market Integrity Rules, Exposure of Client Orders. Under Rule 6.3, the obligation to enter a client order on a marketplace does not apply where the client order is for more than 50 standard trading units.

<sup>8</sup> CSA Notice of Proposed Amendments to National Instrument 21-101, Marketplace Operation, and National Instrument 23-101, Trading Rules, March 18, 2011, [http://osc.gov.on.ca/en/SecuritiesLaw\\_rule\\_20110318\\_21-101\\_rfc-notice-proposed-amendments.htm#s1\\_1\\_1](http://osc.gov.on.ca/en/SecuritiesLaw_rule_20110318_21-101_rfc-notice-proposed-amendments.htm#s1_1_1) (accessed June 14, 2011).

<sup>9</sup> Letter dated January 10, 2011 from Robert Young and Sophia Lee on IIROC and CSA Position Paper 23-405, [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110110\\_23-405\\_young\\_lee.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110110_23-405_young_lee.pdf) (accessed June 14, 2011).



We support this view for several reasons. In many cases, an institution will have more to trade in a name after its first block order is executed in full. Having to expose the residual portion of the original block order could adversely impact execution quality for subsequent block orders in the same name. In addition, in cases where a block crossing system could not execute a non-block residual portion of a block order, an institution would have to use a second broker to execute the residual portion of the order, resulting in higher clearing and settlement charges. Furthermore, institutional traders often seek to handle an order through one broker or venue to minimize the potential market impact costs of exposing an order to more than one broker or venue. The CSA and IIROC position would facilitate this approach.

#### ***IOIs – clarifying that the proposed exemption covers negotiations***

The CSA's proposal with respect to IOIs, read literally, could restrict our existing block negotiation business to the detriment of our institutional customers and the millions of Canadian citizens on whose behalf they invest.

Under National Instrument 21-101, Rule 7.1(1), all orders must be publicly disclosed via an information processor.<sup>10</sup> The CSA proposes a new exception to Rule 7.1(1) through a modification to Rule 7.1(2). Under the CSA's proposed modification, Rule 7.1(1) would not apply "... if the orders posted on the marketplace meet the size threshold set by a regulation services provider."

We believe this proposed exception is intended to cover our existing one-to-one negotiation business, but we are concerned that the term "posted" is too limiting. We are not clear as to whether an order communicated in a one-to-one negotiation would be considered "posted" for this purpose. Accordingly, we would recommend that the term "posted" be changed to "posted or communicated (including through a one-to-one negotiation system)."<sup>11</sup> We would further recommend that the term "on" be changed to "on or by" to conform to Rule 7.1(1).<sup>12</sup>

#### ***IOIs – proposed exemption for derived mid-peg and other calculated-price orders***

We would further propose an additional exemption under Rule 7.1. The order protection rule<sup>13</sup> in National Instrument 23-101 currently provides an exemption for a "calculated-price order," defined in National Instrument 23-101, Section 1.1 as "any order where the price is not known at the time of order entry and is not based, directly or indirectly, on the quoted price of an exchange-traded security at the time the commitment to executing the order was made."<sup>14</sup> The Companion Policy 23-101 to National Instrument 23-101, Section 1.1.3 provides the following examples of a calculated-price order:

<sup>10</sup> Ontario Securities Commission Bulletin, Issue 34/11s1 - March 18, 2011, Ont. Sec. Bull. Issue 34/11s1, Appendix B, [http://osc.gov.on.ca/en/SecuritiesLaw\\_rule\\_20110318\\_21-101\\_rfc-notice-proposed-amendments.htm#s1\\_1\\_1b](http://osc.gov.on.ca/en/SecuritiesLaw_rule_20110318_21-101_rfc-notice-proposed-amendments.htm#s1_1_1b) (accessed June 14, 2011).

<sup>11</sup> We note that this type of exemption is currently provided in the United States under Rule 301(b)(3) of Regulation NMS.

<sup>12</sup> We also propose that the word "and" at the beginning of the new proposed language be changed to "or" as we do not believe it would be possible for a marketplace to limit order display to system operators while at the same time posting orders on the marketplace.

<sup>13</sup> National Instrument 23-101, Sections 6.2(e)(ii) and 6.4 (a)(iv).

<sup>14</sup> National Instrument 23-101, Section 1.1.



a call market order; an opening order; a closing order; a volume-weighted average price order; and a basis order.<sup>15</sup>

We recommend that these types of orders similarly be exempted under Rule 7.1(2) because there is no definitive price associated with the order at the time the order is transmitted. Accordingly, as a practical matter, there is no definitive price that could be displayed to an information processor.

We also would add a fifth example of a calculated-price order for this purpose – a derived mid-peg order. As in the case of the other types of calculated-price order, it is not possible to display a price for a derived mid-peg order because the execution price is derived from the best bid and offer price at the time of execution.<sup>16</sup>

An institution often will want to trade at the mid-point but will not want to post a bid or offer at the mid-point for fear of alerting short-term traders. Derived mid-peg orders (including derived mid-peg IOIs) enable institutions to achieve 100% price improvement without market impact. In addition, because they improve on the displayed price in the market, they do not bypass displayed order flow.

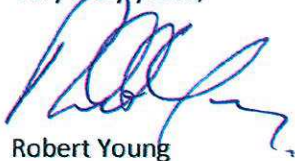
Our proposed modifications will help protect institutions seeking to execute large orders on behalf of millions of long-term investors in Canada without adversely impacting the overall objectives of the Rule Proposals.

### **Conclusion**

The institutions that handle block orders invest and trade on behalf of the significant majority of Canadian citizens. They also represent the most reliable and important source of capital for Canadian corporations. It is important that we provide appropriate flexibility for institutional traders that handle block orders, and for marketplaces that execute institutional block orders, to ensure that we minimize trading costs, and maximize investment returns, for millions of Canadian citizens.

We appreciate the opportunity to comment on the Rule Proposals.

Very truly yours,



Robert Young  
Liquidnet Canada Inc.  
President and CEO



Sophia Lee  
Liquidnet Canada Inc.  
General Counsel

<sup>15</sup> Companion Policy 23-101 to National Instrument 23-101, Section 1.1.3.

<sup>16</sup> We note that it would not make sense to include a derived mid-peg order as an exemption from the order protection rule because derived mid-peg orders by definition will always comply with the order protection rule. However, for the reasons discussed in our letter, it does make sense to include derived mid-peg orders in any exemption from Rule 7.1(1) that is provided for calculated-price orders.

**The benefits of systems that facilitate block trading on behalf of long-term investors -  
comments from institutional investors and industry experts globally**

Systems that facilitate the execution of institutional block orders with reduced market impact reduce trading costs for institutions. The cost savings achieved by institutions through these systems are passed on to hundreds of millions of individual investors globally who invest for the long-term through mutual funds, retirement funds, unit and investment trusts, and other collective investment vehicles. As long-term investors, these institutions represent the most consistent and reliable source of investment capital for companies worldwide.

This document presents written public statements from buy-side institutions, buy-side trade groups, regulators, industry experts and exchanges on the value of systems that facilitate execution of institutional block orders on behalf of long-term investors.<sup>1</sup>

This category of systems include systems like Liquidnet that focus on execution of block orders. It also includes broker-operated dark pools, sometimes referred to as “broker crossing networks.” Many of these systems execute block and non-block orders. In this Exhibit, ***we focus specifically on the value of these types of systems for executing institutional block orders.***

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As emphasized by the U.S. Securities and Exchange Commission in its 2010 “Concept Release on Equity Market Structure,” the protection of long-term investors is a top priority:

“In assessing the performance of the current equity market structure and whether it is meeting the relevant Exchange Act objectives, the Commission is particularly focused on the interests of long-term investors. These are the market participants who provide capital investment and are willing to accept the risk of ownership in listed companies for an extended period of time.

. . . .

Given the difference in time horizons . . . the trading needs of long-term investors and short-term professional traders often may diverge. Professional trading is a highly competitive endeavor in which success or failure may depend on employing the fastest systems and the most sophisticated trading strategies that require major expenditures to develop and operate. Such systems and strategies may not be particularly useful, in contrast, for investors seeking to

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<sup>1</sup> This document does not include comments from sell-side firms or sell-side groups. The Security Traders Association of New York, quoted in this document, includes both buy-side and sell-side representation.



establish a long-term position rather than profit from fleeting price movements. Where the interests of long-term investors and short-term professional traders diverge, the Commission repeatedly has emphasized that its duty is to uphold the interests of long-term investors.”<sup>2</sup>

This document is broken out into five sections – Europe; U.S.; Canada; Australia; and IOSCO.

## **Europe**

On 8 December 2010, the European Commission (EC) published a Public Consultation entitled “Review of the Markets in Financial Instruments Directive (MiFID).”<sup>3</sup> As part of the Public Consultation, the EC solicited comments on various topics relating to MiFID, including equity trading and markets.

In response to the Public Consultation, buy-side institutions and buy-side trade groups consistently highlighted the value of crossing systems for executing large orders with reduced market impact.

The Association of British Insurers (ABI), the voice of the UK’s insurance, investment and long-term savings industry with members constituting over 90 per cent of the insurance market in the UK and twenty per cent across the European Union,<sup>4</sup> wrote:

“Institutional investors such as our members, trading on behalf of their clients who are policyholders or pensioners, are significant users of ‘dark pools’. They do this because they believe that is where they can achieve best execution for some orders. Being able to transact in size away from lit markets reduces the market impact and therefore transaction costs. It is important that investor choice of where to transact business should not be unreasonably constrained.”<sup>5</sup>

In response to a question in the Consultation Paper on whether to mandate public disclosure of “order stubs” (the residual portion of large orders), the ABI wrote:

“We believe that stubs should retain large in scale protections and that MiFID should be clarified to ensure that they can remain dark. There is a risk that the

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<sup>2</sup>Securities Exchange Act Release No. 61358 (January 14, 2010) 75 FR 3594 (January 21, 2010), <http://sec.gov/rules/concept/2010/34-61358fr.pdf> (accessed June 14, 2011), pp. 33-34 (“SEC Concept Release”).

<sup>3</sup> European Commission, “Public Consultation – Review of the Markets in Financial Instruments Directive (MiFID), 8 December 2010, [http://ec.europa.eu/internal\\_market/consultations/docs/2010/mifid/consultation\\_paper\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf) (accessed June 14, 2011).

<sup>4</sup> For more information regarding the ABI, see [http://www.abi.org.uk/About\\_The\\_ABI/role.aspx](http://www.abi.org.uk/About_The_ABI/role.aspx) (accessed June 14, 2011).

<sup>5</sup> Letter dated 2 February 2011 from the Association of British Insurers, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/registered\\_organisation/association\\_insurerspdf/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/registered_organisation/association_insurerspdf/EN_1.0_&a=d) (accessed June 14, 2011), p. 6 (“ABI 2011 Letter”).

exposure of a part of an order which remains unexecuted, and which may be just below the LIS [large-in-scale] threshold, will provide information to other market participants about the original order as a whole thereby frustrating the purpose of the protections afforded to the original order.”<sup>6</sup>

APG Algemene de Pensioens Groep NV (APG) is one of the world’s largest administrators of group pension schemes and is the administrator for the pensions of approximately 4.5 million pension participants in The Netherlands, constituting over 30% of all collective pension schemes in The Netherlands. APG exclusively provides services to pension funds (and pension funds only).<sup>7</sup> APG wrote as follows in response to the Consultation Paper:

“The size of the trades of institutional investors, such as APG, is often very large. These large blocks of trades could have an enormous market impact if they were to be disclosed instantly. Our main concern therefore relates to our ability to execute large orders on behalf of our pension clients with minimal market and price impact.

....

Institutional investors use non displayed markets because they allow an opportunity to trade in size, and away from markets where their large orders interact with those placed by high frequency traders.

....

Institutional investors benefit from crossing networks/dark pools. We would oppose any changes that may increase our costs of trading.

....

Institutional investors need choice of venue to execute their large orders without market impact. We use these non-displayed venues to find sufficient liquidity and to avoid market impact.”<sup>8</sup>

With regard to MiFID’s existing large-in-scale (LIS) waiver, which provides an exemption from pre-trade transparency for large orders, APG wrote:

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<sup>6</sup> ABI 2011 Letter, pp. 11-12.

<sup>7</sup> For more information regarding APG, see <http://www.apg.nl/apgsite/pages/english/about-apg/> (accessed June 14, 2011).

<sup>8</sup> Letter dated 2 February 2011 from Guus Wartinga, Chief Counsel, Legal, Tax, Regulations & Compliance, and Zohre Tali, Senior Legal Counsel, Legal, Tax, Regulations & Compliance, APG Asset Management [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/algemene\\_pensioen/ EN 1.0 &a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/algemene_pensioen/ EN 1.0 &a=d) (accessed June 14, 2011), pp. 3 and 6-7 (“APG Letter”).



“We certainly wish to continue to benefit . . . from the large in scale waiver in order to execute large orders without too large a price impact.”<sup>9</sup>

With respect to order stubs, APG wrote:

“The remaining stubs from larger orders should continue to benefit from the LIS and should not be shown into the lit market. It may unduly affect the costs of trade and the initial execution methodology to treat stubs differently from the block trade that it originally formed part of.”<sup>10</sup>

In response to an EC proposal to require public disclosure of indications of interest (IOIs), APG wrote:

“We currently make use of a crossing platform where the information entered into our order blotter is automatically screened and used to match negotiating market participants. We are not supportive of the [IOI] proposal, if it is the intention that the information entered into our order blotter (and linked to such crossing platform) will constitute actionable IOIs or that such crossing platforms will not be able to continue providing the service they currently provide.”<sup>11</sup>

Baillie Gifford & Co is one of the UK’s leading independently owned investment management firms. Baillie Gifford is based in Edinburgh, Scotland and has been in business for over a century.<sup>12</sup> In response to the Consultation Paper, Baillie Gifford wrote:

“We have provided specific responses overleaf, in summary our key concern is current levels of market impact suffered by our clients in lit venue trading are not acceptable, which is why ‘dark’ trading has become so important to us . . . . With lower levels of capital being committed to risk prices by the market makers following the recent financial crisis, it has become more difficult for institutional clients to trade in large size instantaneously and anonymously, and dark pools now play an important role in maintaining our ability to cross large blocks of stock, very often being the only source of liquidity in thin markets. Increased transparency in this area, therefore, without the correct waivers in place, will be

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<sup>9</sup> APG Letter, p. 12.

<sup>10</sup> APG Letter, p. 13.

<sup>11</sup> APG Letter, pp. 12-13.

<sup>12</sup> For more information regarding Baillie Gifford, see <http://www.bailliegifford.com/> (accessed June 14, 2011).

detrimental to market efficiency, and will ultimately impact the cost of trading to our clients.”<sup>13</sup>

In response to the proposal in the Consultation Paper on order stubs, Baillie Gifford wrote:

“We would also argue strongly for all Stubs from initially dark Large in Scale orders to remain in the dark in order to prevent market leakage of sensitive information on on-going orders.”<sup>14</sup>

With regard to the existing MiFID large-in-scale and reference price waivers (the existing MiFID waivers from pre-trade transparency for large orders and for orders, such as mid-peg orders,<sup>15</sup> that are executed based on a derived price), Baillie Gifford wrote:

“We would urge, however, that the Large in Scale and Reference Price waivers should remain in place in order to allow crossing networks and algorithms the ability to gain 100% price improvement for both sides of a trade, without imposing a minimum order size.”<sup>16</sup>

With regard to the proposal on IOIs in the Consultation Paper, Baillie Gifford wrote:

“We strongly disagree with the proposal regarding ‘actionable indications of interest’ because these rules would prevent institutions having the right to negotiate block orders directly with other institutions through independent crossing networks such as Liquidnet; as noted above, these types of transactions are crucial to our business, especially since the withdrawal of brokers’ capital to facilitate large trades, and they help to reduce our clients’ (and their underlying individual customers’) transaction costs enormously – surely the most intended consequence of the introduction of MiFID in the first place.”<sup>17</sup>

Eumedion is an association in The Netherlands that operates as representative of the interests of institutional investors in the field of corporate governance.<sup>18</sup> Eumedion wrote:

“... a widened MiFID scope should not result in limiting the possibilities of investment firms operating for institutional clients to use crossing systems and

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<sup>13</sup> Letter dated 2 February 2011 from Graham Laybourn, Head of Regulatory Risk, Baillie Gifford & Co., [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/registered\\_organisation/baillie\\_giffordpdf/ EN 1.0 &a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/registered_organisation/baillie_giffordpdf/ EN 1.0 &a=d) (accessed June 14, 2011), pp. 1-2 (“Baillie Gifford Letter”).

<sup>14</sup> Baillie Gifford Letter, p. 4.

<sup>15</sup> “Mid-peg orders” are orders where the execution price is pegged to the mid-point of the best posted bid and offer in the market at the time of execution. Orders executed at the mid-point provide 100% price improvement to both parties to the trade.

<sup>16</sup> Baillie Gifford Letter, p. 4.

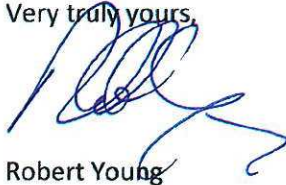
<sup>17</sup> Baillie Gifford Letter, p. 4.

<sup>18</sup> For more information regarding Eumedion, see [http://eumedion.nl/Over\\_Eumedion](http://eumedion.nl/Over_Eumedion) (accessed June 14, 2011).



We appreciate the opportunity to comment on the Rule Proposals.

Very truly yours,



Robert Young  
**Liquidnet Canada Inc.**  
President and CEO



Sophia Lee  
**Liquidnet Canada Inc.**  
General Counsel

dark pooling. These trading instruments are quite common and important for these investment firms to execute large orders in line with their investment policies.”<sup>19</sup>

Eumedion wrote further:

“... we note that such a brokered MiFID regime should not result in limiting important trading abilities for investment firms operating for institutional clients. For instance, crossing systems and dark pooling are important instruments for some investment firms to execute their large orders. Regulating these trading instruments needs to be conducted with due care.”<sup>20</sup>

With regard to the existing MiFID waivers from pre-trade transparency, Eumedion wrote:

“... institutional investors and other wholesale participants, who are essential contributors to liquidity, should continue to be allowed to execute orders of a large scale without a disturbing market impact if the order would be disclosed. Therefore, Eumedion supports the proposal to retain the existing waivers, including the large-in-scale waiver, and the related thresholds.”<sup>21</sup>

The European Fund and Asset Management Association (EFAMA) is the representative association for the European investment management industry. EFAMA represents through its 27 member associations and 51 corporate members approximately EUR 13.5 trillion in assets under management.<sup>22</sup> EFAMA wrote in response to the Consultation Paper:

“Asset managers benefit from placing orders on alternative venues which give them an alternative choice of venue to discover liquidity. They place orders in OTFs [OTC Trading Facilities] solely because they believe it is in the best interests of their clients. In addition, some of our members point out that there is no evidence that crossing order flow away from lit markets is detrimental to those lit markets. There is no evidence, as CESR acknowledged before the

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<sup>19</sup> Letter dated 2 February 2011 from Rients Abma, Executive Director, Eumedion (the Dutch based corporate governance forum for institutional investors in listed companies), [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/registered\\_organisation/eumedionpdf/ EN 1.0 &a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/registered_organisation/eumedionpdf/ EN 1.0 &a=d) (accessed June 14, 2011), p. 2 (“Eumedion Letter”).

<sup>20</sup> Eumedion Letter, p. 3.

<sup>21</sup> Eumedion Letter, pp. 2-3.

<sup>22</sup> For more information regarding EFAMA, see [http://www.efama.org/index.php?option=com\\_content&task=view&id=25&Itemid=58](http://www.efama.org/index.php?option=com_content&task=view&id=25&Itemid=58) (accessed June 14, 2011).



European Parliament, that fragmentation has decreased the proportion of trading on lit markets.”<sup>23</sup>

EFAMA wrote further:

“Some of our members disagree with the Commission’s statement on page 22 that the increased use of dark pools may ultimately affect the quality of price discovery mechanism of the lit markets. They consider that dark pools serve an important and often distinct role from lit markets in the efficient functioning of markets and therefore in respect of achieving optimal investment performance for long-term savers and pensioners.”<sup>24</sup>

In response to the proposal on order stubs in the Consultation Paper, EFAMA wrote:

“A large majority of EFAMA members disagree and support retaining the current regime whereby order stubs remaining from a large in scale order should continue to benefit from the waiver.

....

If the Commission intends to introduce a rule to make stubs pre-trade transparent, we consider there is a need for clear evidence of real adverse impact to be presented. We suspect the costs of any solution would far outweigh any related benefit in place.”<sup>25</sup>

The Investment Company Institute (ICI) is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds and unit investment trusts. ICI members invest on behalf of over 90 million individual shareholders.<sup>26</sup> In response to the Consultation Paper, the ICI wrote:

“Undisplayed liquidity is not a new phenomenon. Funds have long been significant users of undisplayed liquidity and the trading venues that provide such liquidity. These venues provide a mechanism for transactions, particularly the large orders ICI members frequently must execute, to interact without displaying the full scale of a fund’s trading interest. This, in

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<sup>23</sup> Letter dated 2 February 2011 from Peter De Proft, Director General, European Fund and Asset Management Association, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/registered\\_organisation/management\\_associationpd/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/registered_organisation/management_associationpd/EN_1.0_&a=d) (accessed June 14, 2011), pp. 2-3 (“EFAMA 2011 Letter”).

<sup>24</sup> EFAMA 2011 Letter, p. 9.

<sup>25</sup> EFAMA 2011 Letter, p. 10.

<sup>26</sup> For more information regarding the ICI, see [http://ici.org/about\\_ici](http://ici.org/about_ici) (accessed June 14, 2011).

turn, lessens the cost of implementing trading ideas and mitigates the risk of information leakage. These venues also allow funds to avoid transacting with market participants who seek to profit from the impact of the public display of large orders to the detriment of funds and their shareholders. The importance of funds being able to trade efficiently in large size cannot be discounted. As we have stated in several letters to the SEC, the confidentiality of information regarding fund trades is of significant importance to ICI members. Any premature or improper disclosure of this information can lead to frontrunning of a fund's trades, adversely impacting the price of the stock that the fund is buying or selling."<sup>27</sup>

The ICI wrote as follows with regard to the use of the terms "dark liquidity" and "dark pools":

"As a preliminary matter, we believe it is unfortunate that such pejorative terms 'dark liquidity' and 'dark pools' have become ingrained in the terminology used by the securities markets and policy makers to describe a type of liquidity and trading venue that has brought certain benefits to all kinds of market participants, including funds and their shareholders. We therefore are reluctant to use these terms when discussing issues surrounding this part of the market structure and urge that alternative terms be established."<sup>28</sup>

With regard to potential reforms to MiFID, the ICI wrote:

"... there is real value in enabling entities that frequently trade in large amounts to have access to venues that do not disclose their trading interest. We therefore believe it is imperative that venues trading undisplayed liquidity remain available to funds and that the regulations overseeing these venues facilitate their continued use. We would be concerned if any reforms to MiFID impeded funds as they trade securities in venues providing undisplayed liquidity, whether it be through trading large blocks or through other trading methods."<sup>29</sup>

With regard to the existing MiFID waivers from pre-trade transparency, the ICI wrote:

"We strongly support the flexibility provided by pre-trade transparency waivers and the Commission's recognition that the reasons for allowing

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<sup>27</sup> Letter dated February 2, 2011 from Karrie McMillan, General Counsel, the Investment Company Institute, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/investment\\_institutepdf/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/investment_institutepdf/EN_1.0_&a=d) (accessed June 14, 2011), p. 16 ("ICI 2011 Letter").

<sup>28</sup> ICI 2011 Letter, p. 16.

<sup>29</sup> ICI 2011 Letter, p. 17.



waivers still appear valid. We believe that any changes to waivers must be carefully crafted to not create difficulties for investors when executing orders.”<sup>30</sup>

In its comment letter, the ICI also discusses the importance of giving specific consideration to systems “that are critical for funds in the anonymous execution of large-sized orders”:

“It also will be important for the Commission to consider the varying business models and the trading mechanisms of venues providing undisplayed liquidity. For example, block crossing networks in the United States offer specific size discovery mechanisms that are critical for funds in the anonymous execution of large-sized orders. Other trading facilities operate in a manner more akin to broker-dealer trading venues; we believe these latter systems arguably should be treated differently from those such as block crossing networks for purposes of regulation.”<sup>31</sup>

The ICI also discusses execution quality provided by non-lit markets:

“Finally, we understand that questions have been raised regarding the order execution quality provided to investors and the associated costs of executing orders in venues providing undisplayed liquidity as compared to the ‘lit’ markets. In general, the ICI believes that the quality of execution provided by these trading facilities to funds is very good and it is no more costly (and may in certain situations be less costly) for investors to trade in venues providing undisplayed liquidity.”<sup>32</sup>

The Irish Association of Investment Managers (IAIM), the representative association for institutional investment managers in Ireland,<sup>33</sup> wrote:

“As we have touched-upon above, the implicit prioritization in the Document to the improvement of transparency seems to envisage the concept in isolation. There is a clear interactivity between transparency and the other features of strong, well regulated, efficient markets. As such, while it should be possible to improve pre- and post- trade transparency without materially impacting upon other necessary features such as liquidity and cost, the proposals could potentially have materially adverse, if entirely unintended, effects. In specific

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<sup>30</sup> ICI 2011 Letter, p. 15.

<sup>31</sup> ICI 2011 Letter, p. 17.

<sup>32</sup> ICI 2011 Letter, p. 17.

<sup>33</sup> For more information regarding the IAIM, see <http://www.iaim.ie/> (accessed June 14, 2011).

terms, the possibility that institutional investors may be denied access to large scale liquidity, such as those in dark pools, should be considered carefully.”<sup>34</sup>

Shell Asset Management Company B.V. (SAMCo), the dedicated asset manager for the Royal Dutch Shell Group with responsibility for managing its pension fund,<sup>35</sup> wrote:

“While we are generally in favour of the broadened application of MiFID requirements as proposed, our main concerns relate to those proposals that may impact our ability to execute large orders on behalf of our clients (often by using specialized crossing systems) with minimal market and price impact. We are therefore not in favour of proposals that . . . may hinder us in making information available to crossing platforms or in dark pools without it automatically becoming pre-trade transparent.”<sup>36</sup>

With regard to the proposal in the Consultation Paper on IOIs, SAMCo wrote:

“Certain crossing platforms automatically screen the information entered onto an order blotter and use such information to match negotiating market participants – however without leading to an automatic order or trade. The buyer and the seller are allowed to negotiate the price for the trade once a match is found. If it is the intention that such crossing platforms will not be able to continue providing the services they currently provide or that information entered onto our order blotters could come to constitute actionable IOIs, we are not supportive of the proposal.”<sup>37</sup>

SAMCo wrote further with regard to the EC’s proposal on order stubs:

“Order stubs should continue to benefit from the large-in-scale waiver, as we believe that it may unduly affect the cost of trade and the initial execution methodology to treat stubs differently from the block trade that it originally formed part of.”<sup>38</sup>

With regard to the existing large-in-scale waiver, SAMCo wrote:

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<sup>34</sup> Letter dated 2 February 2011 from Frank O’ Dwyer, Chief Executive, and Enda Mc Mahon, Chairman, Regulation & Compliance Committee, the Irish Association of Investment Managers, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/association\\_managerspdf/ EN 1.0 &a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/association_managerspdf/ EN 1.0 &a=d) (accessed June 14, 2011), p.4.

<sup>35</sup> For more information regarding SAMCo, see <http://www.iaim.ie/> (accessed June 14, 2011).

<sup>36</sup> Letter dated 1 February 2011 from Bart van der Streenstraten, Managing Director, Shell Asset Management Company B.V., [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/management\\_company/ EN 1.0 &a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/management_company/ EN 1.0 &a=d) (accessed June 14, 2011), p. 1 (“SAMCo Letter”).

<sup>37</sup> SAMCo Letter, p. 3.

<sup>38</sup> SAMCo Letter, p. 4.



As an institutional buy-side investment firm, we wish to continue to benefit from the large-in-scale waiver to the maximum extent possible and would therefore favour the lowering of large in scale waivers thresholds (i.e. that a transaction will earlier qualify for a large in scale waiver than is currently the case). We are certainly not in favour of such thresholds being increased.”<sup>39</sup>

Standard Life Investments, a global asset manager based in Edinburgh, Scotland that trades on behalf of five million clients worldwide,<sup>40</sup> wrote as follows with respect to the MiFID pre-trade transparency waivers:

“We suggest that the current pre-trade waivers continue to be applied to allow large block crossing to take place in systems such as Liquidnet, ITG and in ‘broker dark pools’.”<sup>41</sup>

With regard to the EC’s proposal on IOIs, Standard Life wrote:

“Actionable IOIs should be treated as orders but we urge that the pre-trade waivers continue to be applied to allow large block crossing to take place in systems such as Liquidnet, ITG and in ‘broker dark pools’. Forcing this business onto the lit market would drive execution costs significantly higher for large buy-side orders.”<sup>42</sup>

In response to the EC’s proposal on order stubs, Standard Life wrote:

“We suggest that no change is made in the treatment of order stubs. If stubs were forced onto the lit market it would make the crossing of blocks far less likely and would drive execution costs higher.”<sup>43</sup>

Wellington Management Company, llp, a global investment manager with approximately US\$634 billion in client assets under management,<sup>44</sup> wrote as follows in response to the EC Consultation Paper:

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<sup>39</sup> Shell Letter, p. 4.

<sup>40</sup> For more information regarding Standard Life Investments, see [http://www.standardlifeinvestments.com/about\\_us/company\\_overview/index.html](http://www.standardlifeinvestments.com/about_us/company_overview/index.html) (accessed June 14, 2011).

<sup>41</sup> Letter from Standard Life Investments, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/standard\\_investmentpdf/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/standard_investmentpdf/EN_1.0_&a=d) (accessed June 14, 2011), p. 7 (“Standard Life Letter”).

<sup>42</sup> Standard Life Letter, p. 6.

<sup>43</sup> Standard Life Letter, p. 6.

<sup>44</sup> For more information regarding Wellington Management, see [http://www.wellington.com/Who\\_We\\_Are/Overview/](http://www.wellington.com/Who_We_Are/Overview/) (accessed June 14, 2011).

“As a fund manager for large institutions, we routinely use BCSs [broker crossing systems] for large orders to avoid market impact that might arise if other market participants were to trade ahead of our orders. We generally instruct firms not to display our orders where such non-display is judged to benefit execution quality.

. . . .

. . . we support certain BCSs referred to as ‘crossing networks’ which offer a trading platform for institutional investors to interact with each other for the purpose of crossing large block orders. We also believe that the means commonly used on a voluntary basis to notify institutional investors of a crossing opportunity should not be considered a general market quotation or otherwise be subject to prohibition or forced pre-trade transparency.”<sup>45</sup>

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In 2010 the Committee of European Securities Regulators (CESR) published three papers soliciting comments on various issues relating to MiFID (CESR 2010).<sup>46</sup> In response to the CESR 2010 consultation papers, buy-side firms and buy-side industry groups were uniform in their support for systems that facilitate execution of block orders.

The European Fund and Asset Management Association (EFAMA) wrote:

“Crossing networks fulfill an important role for institutional investors, enabling them to minimize market impact and opportunity cost for large orders.”<sup>47</sup>

The Association of British Insurers (ABI) wrote:

“[F]or investors trading in size, total transparency is not always a panacea. Some kind of hidden liquidity has always existed as is the case now with dark

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<sup>45</sup> Letter dated 2 February 2011 from David Cushing, Director of Global Equity Trading, Wellington Management Company, LLP, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/individuals\\_others/wellington\\_managementpdf/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/wellington_managementpdf/EN_1.0_&a=d) (accessed June 14, 2011), p. 5.

<sup>46</sup> “CESR Technical advice to the European Commission in the context of the MiFID review – Transaction Reporting - CESR 10-292”, 13 April 2010, [http://www.cesr.eu/data/document/10\\_796.pdf](http://www.cesr.eu/data/document/10_796.pdf) (accessed June 14, 2011). “CESR Technical advice to the European Commission in the context of the MiFID review – Equity Markets - CESR 10-394”, 13 April 2010, [http://www.cesr.eu/data/document/10\\_975.pdf](http://www.cesr.eu/data/document/10_975.pdf) (accessed June 14, 2011). “CESR Technical advice to the European Commission in the context of the MiFID review – Investor protection and Intermediaries – CESR 10-417”, 13 April 2010, <http://www.cesr.eu/popup2.php?id=6544> (accessed June 14, 2011).

<sup>47</sup> Letter dated 1 June 2010 from Peter De Proft, European Fund and Asset Management Association, “EFAMA Reply to CESR’s Consultation Paper on Technical Advice to the European Commission in the context of the MiFID review – Equity Markets,” [http://www.esma.europa.eu/index.php?page=response\\_details&c\\_id=161&r\\_id=5648](http://www.esma.europa.eu/index.php?page=response_details&c_id=161&r_id=5648) (accessed June 14, 2011).



pools and broker crossing networks. . . . The trade size has decreased and our members sometimes have to balance the trade-off between total transparency when using regulated markets open to high frequency traders and others, and decreased market impact and liquidity for large orders when trading over the counter, whether in dark pools or crossing networks.”<sup>48</sup>

The ABI wrote further:

“Institutional investors such as our members, trading on behalf of their clients who are policyholders or pensioners, are significant users of dark pools. They do this because they believe that is where they can achieve best execution for some orders. That, in turn, is because being able to transact in size away from lit markets reduces the market impact and therefore transaction costs.”<sup>49</sup>

Fidelity International Limited (FIL), which provides asset management services to investors all over the world outside the US and Canada,<sup>50</sup> wrote:

“Dark venues provide significant benefits to institutional clients’ whose flow tends to be large in size. Benefits include reduced market impact, lower information leakage and larger fills than on traditional public and light alternatives.”<sup>51</sup>

FIL further pointed out:

“Institutional investors benefit from broker crossing networks / dark pools and we are opposed to any signaling from them to the lit market that may increase our cost to trade.”<sup>52</sup>

Wellington Management Company wrote:

“As a fund manager, we routinely use broker crossing networks (BCNs) for large orders to avoid market impact that might arise if other market participants were

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<sup>48</sup> ABI Response to the CESR Consultation on Equity Markets, [http://www.esma.europa.eu/popup\\_responses.php?id=5538](http://www.esma.europa.eu/popup_responses.php?id=5538) (accessed June 14, 2011), p. 2 (“ABI 2010 Letter”).

<sup>49</sup> ABI 2010 Letter, p. 11.

<sup>50</sup> For more information regarding FIL, see <https://www.fidelity-international.com/global/default.page> (accessed June 14, 2011).

<sup>51</sup> FIL response to CESR’s Consultation Paper on Technical Advice to the European Commission in the context of the MiFID Review – Equity Markets, [http://www.esma.europa.eu/popup\\_responses.php?id=5616](http://www.esma.europa.eu/popup_responses.php?id=5616) (accessed June 14, 2011), p. 1 (“FIL Letter”).

<sup>52</sup> FIL Letter, p. 7.

to trade ahead of our orders. We generally instruct firms not to display our orders where such non-display is judged to benefit execution quality.”<sup>53</sup>

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In November 2008 CESR published a “Call for evidence on the impact of MiFID on secondary markets functioning,” (CESR 2008) seeking feedback from market participants in Europe on the impact of the Markets in Financial Instruments Directive (MiFID).<sup>54</sup> As part of this process, CESR solicited feedback from market participants on various topics relating to the secondary markets, including dark pools.

The significant majority of responding parties, including many buy-side market participants who invest on behalf of tens of millions of European citizens, identified the benefits of dark pools for executing large orders.

The ABI wrote:

“Our members believe there are benefits to the dark pools of liquidity, namely the reduction of market impact as CESR highlights. Portfolio managers often trade in large sizes so minimising market impact – and thus reducing the cost of trading - is of great importance to them.”<sup>55</sup>

The Investment Management Association, the trade body for the UK’s asset management industry,<sup>56</sup> wrote:

“IMA members believe that dark pools are helpful in trading large blocks of stock particularly in minimising market impact and in achieving best execution.”<sup>57</sup>

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Other market participants in Europe concur with the views of the buy-side as to the benefits of crossing systems that trade large orders. In response to CESR 2010, the London Stock Exchange plc and Borsa Italiana identified the benefits of dark pools for executing large orders without market impact:

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<sup>53</sup> Wellington Management Company Letter to Committee of European Securities Regulators, CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets, Ref: CESR/10-394 (May 31, 2010), [http://www.esma.europa.eu/popup\\_responses.php?id=5512](http://www.esma.europa.eu/popup_responses.php?id=5512) (accessed June 14, 2011), p. 4.

<sup>54</sup> Ref. CESR/08-872, 3 November 2008.

<sup>55</sup> “Call for evidence on the impact of MiFID on secondary market functioning - The ABI’s Response to CESR 08-872”, January 2009, [http://www.esma.europa.eu/popup\\_responses.php?id=4436](http://www.esma.europa.eu/popup_responses.php?id=4436) (accessed June 14, 2011).

<sup>56</sup> For more information regarding the IMA, see [www.investmentuk.org](http://www.investmentuk.org) (accessed June 14, 2011).

<sup>57</sup> “Call for Evidence on the Impact of MiFID on Secondary Market Functioning”, 8 January 2009.



“Whilst participants want and need sufficient transparency to create market confidence, this should not undermine their ability to deliver an investment return to end customers or to achieve execution certainty for larger orders without adverse market impact. Therefore, allowing non-displayed trading to take place within the parameters of the appropriate waivers is essential to provide choice and flexibility for end investors, without undermining the execution certainty of displayed orders and at the same time preserving the competitiveness of public order books.”

In response to CESR 2008, NYSE Euronext wrote:

“The trend towards smaller execution sizes in central ‘lit’ order books boosts the demand for alternative trading models. Dark pools respond to this demand by offering the industry a place for trading large orders with minimal impact on prices and allow professional investors to search counterpart[ies]. Therefore, we strongly believe that there are benefits in offering services complementary to order books.”<sup>58</sup>

More recently, in response to the EC’s December 2010 Consultation Paper, NYSE Euronext wrote:

“It is important to allow large transactions to occur without any pre-trade transparency, whether they are pre-negotiated or not. The reason for this exemption is to protect the market from unnecessary price fluctuations and heightened volatility. Stable markets are in the interest of all investors.”<sup>59</sup>

Steve Grob, Director of Group Strategy at Fidessa (London), a technology vendor, remarked recently in a Finextra article:

“The concept that dark pools are ‘always bad’ is naive on a number of levels. Firstly, the term ‘dark pools’ covers a whole host of different non-lit order matching services. These range from buy-side crossing networks, through discretionary broker services, to dark books operated by exchanges and MTFs. These different pools offer a range of different services to professional investors so that they can minimise market impact and achieve the best possible outcome for their orders. Secondly, the concept of trading off-exchange – or ‘in the dark’ – has existed for as long as the exchanges themselves. Many of the broker dark pools are simply automated versions of their traditional ‘upstairs’ activity that seek to deliver on the brokers’ fiduciary duty to get the best possible outcome

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<sup>58</sup>“Comments from NYSE Euronext in Response to CESR’s Call for Evidence on the Impact of MiFID on Secondary Markets Functioning (CESR/08-872)”, January 2009, [http://www.esma.europa.eu/popup\\_responses.php?id=4464](http://www.esma.europa.eu/popup_responses.php?id=4464) (accessed June 14, 2011).

<sup>59</sup> Letter dated February 2, 2011 from NYSE Euronext, [http://circa.europa.eu/Public/irc/markt/markt\\_consultations/library?l=/financial\\_services/mifid\\_instruments/regulated\\_organisation/nyse\\_euronextpdf/EN\\_1.0\\_&a=d](http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/regulated_organisation/nyse_euronextpdf/EN_1.0_&a=d) (accessed June 14, 2011), p. 14.

for their clients. For many pension and traditional long-only funds the idea that they can, or should, trade the huge blocks they do on lit markets is bizarre. Take Liquidnet, for example, which prints average trade sizes that are hundreds or thousands of times larger than trades in the same stocks on lit markets.”<sup>60</sup>

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Buy-side traders in Europe and the U.S. have specifically identified Liquidnet as an example of a trading venue that reduces execution costs for their block orders.

Kevin Chapman, Managing Director of Nicholas-Applegate Capital Management, stated:

“I’d rather see the traders using aggregators like. . . Liquidnet. . . because that would tell me they’re sourcing their own liquidity and trying to get a good execution.”<sup>61</sup>

Kristian West, Head of Equity Trading, JP Morgan Investment Management, stated:

“Overall, we use a relatively small subset of firms to access the fragmented pools of liquidity. These are platforms we trust. For example, we have access to Liquidnet and that for us is an opportunity to cross liquidity ‘upstairs’ before it hits the market.”<sup>62</sup>

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Kay Swinburne, an MEP from Wales, the European Conservatives and Reformists (ECR) Group's Coordinator on the Economics and Monetary Committee in the European Parliament and the ECR Group's Coordinator on the Special Committee on the Financial, Economic and Social Crisis, recently commented favorably on Liquidnet and other systems that seek to address the specific needs of long-term investors:

“I have been watching the development of NASDAQ OMX's latest US equity platform that has a minimum size order threshold, rewarding size not frequency of trade, as well as the progress of buy-side only MTFs like Liquidnet that choose to build in latency to their systems in order to filter participants wishing to access their systems.

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<sup>60</sup>Steve Grob, “Brussel Spouts”, *Finextra*, November 26, 2010, <http://www.finextra.com/community/fullblog.aspx?id=4755> (accessed June 14, 2011).

<sup>61</sup>“TCA plugs you into the front office”, *Buy-Side Technology*, November 1, 2009, [http://db.riskwaters.com/public/showPage.html?validate=0&page=bst\\_login&url=%2Fpublic%2FshowPage.html%3Fpage%3D870805](http://db.riskwaters.com/public/showPage.html?validate=0&page=bst_login&url=%2Fpublic%2FshowPage.html%3Fpage%3D870805) (accessed June 14, 2011).

<sup>62</sup>“What doesn’t kill you . . .”, *The Trade*, December 1, 2009, <http://www.thetradenews.com/what-doesn%E2%80%99t-kill-you-%E2%80%A6> (accessed June 14, 2011).



Both of these methods have been discussed by regulators on both sides of the Atlantic, yet thankfully, no one has looked to impose blanket solutions to entire markets. The more market solutions and options for investors that spring up to fill the gap between the perceived weaknesses in the market and its ability to serve its primary purpose, the less regulation we will need to come up with to fill the void.”

In this passage, MEP Swinburne suggests that regulators should look favorably upon “market solutions” like Liquidnet that seek to address specific problems in the market. Liquidnet provides a market solution to address the challenges faced by institutions in executing block orders on behalf of long-term investors.

### **United States**

Mary L. Schapiro, Chairman of the U.S. Securities and Exchange Commission, stated on December 8, 2010 in testimony before two U.S. Senate sub-committees:

“Many institutional investors value the opportunity to trade in dark venues because of a fear that trading in the public markets in large sizes will cause prices to run away from them. We will explore all aspects of this issue to reach a balanced conclusion. At the end of the day, investors of all types must have confidence that our market structure provides high-quality price discovery and the tools they need to meet their investment objectives in a fair and efficient manner.”<sup>63</sup>

In its “Concept Release on Equity Market Structure” issued in 2010 (the SEC Concept Release), the U.S. Securities and Exchange Commission (SEC) identified the benefits of systems that facilitate the execution of large institutional orders.<sup>64</sup> The SEC wrote:

“In general, dark pools offer trading services to institutional investors and others that seek to execute large trading interest in a manner that will minimize the movement of prices against the trading interest and thereby reduce trading costs.”<sup>65</sup>

The SEC wrote further:

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<sup>63</sup> Testimony by Mary L. Schapiro, Chairman of the U.S. Securities and Exchange Commission, on December 8, 2010 before the Subcommittee on Securities, Insurance, and Investment of the United States Senate Committee on Banking, Housing, and Urban Affairs and the United States Senate Permanent Subcommittee on Investigations in recent testimony on U.S. Equity Market Structure by the U.S. Securities and Exchange Commission, <http://www.sec.gov/news/testimony/2010/ts120810mls.htm> (accessed June 14, 2011).

<sup>64</sup> SEC Concept Release.

<sup>65</sup> SEC Concept Release, p. 18.

“An important objective of many dark pools is to offer institutional investors an efficient venue in which to trade in large size (often by splitting a large parent order into many child orders) with minimized market impact.”<sup>66</sup>

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In their comment letters on the SEC Concept Release, buy-side institutions expressed similar views regarding the value of systems that facilitate execution of block orders.

According to the Investment Company Institute:

“Funds have long been significant users of undisplayed liquidity and the trading venues that provide such liquidity. These venues provide a mechanism for transactions to interact without displaying the full scale of a fund’s trading interest, thereby lessening the cost of implementing trading ideas and mitigating the risk of information leakage. These venues also allow funds to avoid transacting with market participants who seek to profit from the impact of the public display of large orders to the detriment of funds and their shareholders. As we have stated in several letters to the Commission, the confidentiality of information regarding fund trades is of significant importance to Institute members. Any premature or improper disclosure of this information can lead to front-running of a funds’ trades, adversely impacting the price of the stock that the fund is buying or selling.

. . . .

We therefore believe it is imperative that venues trading undisplayed liquidity remain available to funds. We would be concerned if any Commission proposal impeded funds as they trade securities in venues providing undisplayed liquidity, whether it be through trading large blocks or through other trading methods.”<sup>67</sup>

The Investment Adviser Association, a not-for-profit association that represents the interests of more than 500 investment adviser firms that are registered with the SEC,<sup>68</sup> wrote:

“In this regard, dark pools have been critically important in assisting investment managers to minimize market impact costs. These dark pools have permitted large orders to be executed without publicly disseminating the investment

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<sup>66</sup> SEC Concept Release, p. 68.

<sup>67</sup> Letter dated April 21, 2010 from Karrie McMillan, General Counsel, Investment Company Institute, <http://sec.gov/comments/s7-02-10/s70210.shtml> (accessed June 14, 2011), pp. 12-13.

<sup>68</sup> For more information regarding the Investment Adviser Association see <https://www.investmentadviser.org/eweb/dynamicpage.aspx?webcode=BackgroundMission> (accessed June 14, 2011).



manager's trading interests and strategy. We agree with many of the comments to the Commission's proposal to regulate non-public trading interest that trading venues providing undisplayed liquidity are important trading centers for asset managers that seek to minimize market impact (both implicit and explicit) costs for their client trades."<sup>69</sup>

The Vanguard Group, Inc., one of the world's largest investment companies,<sup>70</sup> wrote,

"Vanguard believes large block crossing networks that match large institutional clients at prices between the NBBO play a valuable role in today's markets."<sup>71</sup>

T. Rowe Price Associates, Inc., a global investment management firm that manages more than US\$500 billion in assets,<sup>72</sup> wrote,

"Almost all institutional investors, including T. Rowe Price, utilize trading venues that allow access to undisplayed liquidity. T. Rowe Price strongly takes the position that these 'dark pools' are a vital tool for institutional investors with large blocks of stock to buy and sell. Institutional investors highly value the specialized size discovery mechanisms that bring large buyers and sellers in the same stock together anonymously and to facilitate a trade between them. We would not be supportive of any regulation that negatively impacts our ability to access these pools of undisplayed liquidity."<sup>73</sup>

The Security Traders Association of New York, Inc., the largest affiliate of the Security Traders Association, a professional association of buy-side and sell-side traders,<sup>74</sup> wrote:

"As the Commission has acknowledged there is a need for targeted size discovery mechanisms that enable investors to trade efficiently in size orders and undisplayed liquidity is often used by those wishing to avoid adverse market impact when executing their trades.

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<sup>69</sup> Letter dated April 20, 2010 from Jennifer S. Choi, Assistant General Counsel, Investment Adviser Association, <http://sec.gov/comments/s7-02-10/s70210.shtml> (accessed June 14, 2011), p. 2.

<sup>70</sup> For more information regarding Vanguard see <https://personal.vanguard.com/us/content/Home/WhyVanguard/AboutVanguardWhoWeAreContent.jsp> (accessed June 14, 2011).

<sup>71</sup> Letter dated April 21, 2010 from George U. Sauter, Managing Director and Chief Investment Officer, The Vanguard Group, Inc., <http://sec.gov/comments/s7-02-10/s70210.shtml> (accessed June 14, 2011), p. 5.

<sup>72</sup> For more information regarding T Rowe Price see <http://corporate.troweprice.com/ccw/home/ourCompany/aboutUs/investmentApproach.do> (accessed June 14, 2011).

<sup>73</sup> Letter dated April 21, 2010 from Michael Gitlin, Head of Global Trading, David Oestreicher, Chief Legal Counsel, and Christopher P. Hayes, Senior Legal Counsel, T. Rowe Price Associates, Inc., <http://sec.gov/comments/s7-02-10/s70210.shtml> (accessed June 14, 2011), p. 3.

<sup>74</sup> For more information regarding the Security Traders Association see <http://securitytraders.info/about-the-sta/> (accessed June 14, 2011).

....

We do not believe that the existence of undisplayed liquidity has materially harmed price discovery. Despite the existence of ATs and dark pools displayed markets continue to prosper. The best measure of price discovery is quoted spreads. If there is not enough incentive to post limit orders, the result would be a widening of quoted spreads because intermediaries would charge more to post limit orders. But all the data shows that quoted spreads are narrowing. The narrowing of quoted spreads directly contradicts the assertion that dark pools or internalization are negatively affecting price discovery. The aggregate market share of lit markets as a percentage of overall market volume has remained relatively constant over time.

....

We have repeatedly heard that institutions representing long term investors through mutual funds feel it is imperative that the choice of interacting in the public markets be left with the investment professional making investment decisions.”<sup>75</sup>

Fidelity Investments expressed a similar view in its response to the SEC’s rule proposal on “Regulation of Non-Public Trading Interest”<sup>76</sup>:

“Fidelity uses a wide variety of trading venues and trading strategies to execute client orders as efficiently as possible, and we do not favor one type of trading business model or trading venue over others. On balance, we believe that a framework that supports multiple, competing trading venues is good for the securities industry. Dark pools (and other dark sources of liquidity) enable large market participants to shield their trading objectives by placing orders without having to display their full trading intentions to the entire market. As a result, dark pools can reduce transaction costs by limiting potential information leakage and associated market impact that can occur when trading significant blocks of stock. Fidelity believes that these dark pools are important tools that enable us to execute trades efficiently while protecting our long-term investors from potentially opportunistic trading strategies.”<sup>77</sup>

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<sup>75</sup> Letter dated April 30, 2010 from Kimberly Unger, Executive Director, The Security Traders Association of New York, Inc., <http://sec.gov/comments/s7-02-10/s70210.shtml> (accessed June 14, 2011), p. 10-11.

<sup>76</sup> Securities Exchange Act Release No. 60997 (November 13, 2009), 74 FR 224 (November 23, 2009), <http://sec.gov/rules/proposed/2009/34-60997fr.pdf> (accessed June 14, 2011).

<sup>77</sup> Letter dated February 23, 2010 from Scott C. Goebel, Senior Vice President, General Counsel, FMR Co., <http://sec.gov/comments/s7-24-09/s72409.shtml> (accessed June 14, 2011), p. 2.



In a September 24, 2009 speech, Paul Schott Stevens, the President of the Investment Company Institute, discussed the importance of controlling market impact costs. Mr. Stevens defined market impact as “the amount by which the price of a stock moves against the trader during the time it takes to execute the trade.”<sup>78</sup> “The bigger the trade,” Mr. Stevens said, “the greater the risk of an adverse price movement.”<sup>79</sup> According to an article reporting on his remarks, “Mr. Stevens noted that the development of new venues for trading, such as dark pools, have helped funds reduce their trading costs.”<sup>80</sup>

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The views of the buy-side have been echoed by other market participants and by many of the leading industry experts on trading and market structure and by academics with expertise on trading and market structure.

Robert Greifeld, Chief Executive Officer of Nasdaq, the world’s largest electronic stock exchange, stated as follows in response to a question on dark pools during a recent television interview with Steve Forbes, the owner and editor-in-chief of *Forbes* magazine:

“... a dark pool that’s doing a large size, that’s clearly a value added, because we know today that if you come into the lit market with larger size, you have a disproportionate impact on the lit market.”<sup>81</sup>

According to a report by the TABB Group, a research and consulting firm that conducts extensive research on trading and markets,

“... institutional investors tend to keep their trades quiet and not telegraph their intentions. Many investors feel that by placing limit orders or showing their hand, they will leak information into the market and invite other traders to take advantage of them.”<sup>82</sup>

The TABB Group wrote similarly in another report:

“In fact, there are numerous executions that fall between 2,000-9,000 shares. This subcategory of blocks, sometimes referred to as the ‘demi-block,’ has

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<sup>78</sup> “ICI Wants Wider Debate On Markets”, *Compliance Reporter*, December 4, 2009, <http://www.compliancereporter.com/SubContent.aspx?ArticleID=2352170> (accessed June 14, 2011) (“Compliance Reporter”).

<sup>79</sup> *Compliance Reporter*.

<sup>80</sup> *Compliance Reporter*.

<sup>81</sup> “Interview with Robert Greifeld, Intelligent Investing with Steve Forbes,” December 3, 2010, [http://www.forbes.com/2010/12/03/greifeld-nasdaq-psx-intelligent-investing-video.html?partner=daily\\_newsletter](http://www.forbes.com/2010/12/03/greifeld-nasdaq-psx-intelligent-investing-video.html?partner=daily_newsletter) (accessed June 14, 2011).

<sup>82</sup> Adam Sussman, Larry Tabb, and Robert Iati, The TABB Group, LLC, “US Equity High Frequency Trading: Strategies, Sizing and Market Structure”, September 2009, p. 22.

grown over the past few years. These prints are significantly larger than the average 300 share print found on most liquidity venues, but smaller than the traditional over 10,000 share blocks. Even some volume from traditional block dark pools falls into this segment. Trades within this category can have just as much market impact as those at the 50,000 share range.”<sup>83</sup>

Quantitative Services Group, a provider of advanced trading analytics and investment consulting services, wrote similarly in a recent report:

“It’s well known that sophisticated stat-arb models routinely monitor market data and the depth of limit order books to detect asymmetries in trading interests. The goal is to exploit and profit from them before the flows reverse and larger traders have a chance to finish their orders. These HFT strategies increase the costs of completing institutional trades and often introduce ‘adverse selection’ as orders are completed in names that are moving contrary to the institutional trader’s investment goals.”<sup>84</sup>

According to Wayne Wagner, at the time Chairman of Plexus Group, a pioneer in transaction cost analysis for institutional investors, in testimony before the United States Congress in March 2003:

“For institutional trades to squeeze through the market, they must be ground down to a size that can be accommodated in the market. In the process, the time to complete the order necessarily lengthens.

This creates opportunities for market insiders and middlemen to make money through unnecessary inter-positioning and parasitical front-running. The resulting delay and impact costs reduce investment performance.

The best market for small investor trades may not serve very well those same small investors who invest via mutual funds and other co-mingled investments. Facilities where large buyers can meet large sellers without leakage will benefit all investors.”<sup>85</sup>

According to Professor Robert Schwartz, Marvin M. Speiser Professor of Finance and University Distinguished Professor at the Zicklin School of Business, Baruch College, CUNY,

“As noted, quantity discovery is a major function of a marketplace. While a market center such as the NYSE may play the dominant role with regard to price

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<sup>83</sup> Matthew Simon, The TABB Group, LLC, “US Equity Trading 2010/2011: Outflows, Outrage, and Balance”, December 2010, p. 40.

<sup>84</sup> Quantitative Research Group LLC, “Beware of the VWAP Trap”, *Research Note*, November 2009, p. 3.

<sup>85</sup> Wayne H. Wagner, Chairman of Plexus Group, Testimony before the Committee on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, United States House of Representatives, Washington, D.C., March 12, 2003, p. 6.



discovery, an ATS such as Liquidnet or ITG's Posit can play a major role with regard to quantity discovery. These systems do so by enabling large buyers and sellers to meet directly.

An ATS's quantity discovery role can beneficially effect price discovery for the broader marketplace. If restrictions are placed on how large buy orders can meet large sell orders away from a primary market center, price dislocations can occur. That is, elephants that are not able to trade with each other can upset the apple cart (or, some might say, the alpha cart) and cause a sharp accentuation of intra-day price volatility.”<sup>86</sup>

According to Benn Steil, Senior Fellow in International Economics at the Council on Foreign Relations,

“The problem is that continuous electronic auction markets, as useful as they are, have flaws that are apparent to any institutional trader. They require institutional-sized orders to be chopped up into small bits, each often as little as 1 percent of actual order size, and executed over days or weeks in order to avoid huge market impact costs. That's why in every major U.S. or European marketplace -- New York, Nasdaq, London, Frankfurt, Paris -- about 30 percent of trading volume is executed in blocks, "upstairs," away from these systems.

More importantly, new electronic systems are expanding to make this block trading more efficient. Liquidnet is the most prominent example. By forswearing limit-order display, or ‘pre-trade transparency,’ in favor of a structure in which potential matches are revealed only to the relevant buyer and seller, institutions are encouraged to reveal their true order size to the system.”<sup>87</sup>

Dr. James J. Angel, Associate Professor at the McDonough School of Business at Georgetown University, an expert on the structure and regulation of global financial markets, recently explained as follows in a comment letter on the SEC’s Concept Release:

“Large traders have always been concerned about reducing the price impact of their trades. One of the ways to do this is to limit exposure of their trading interest only to parties who are very likely to trade with them. This limited disclosure reduces the likelihood that other traders will try to go along and trade at the same time and increase the market impact of the order. Whether in the murky depths of the ancient NYSE floor, or in the telephone conversations of upstairs block traders, limited disclosure is a longstanding and useful practice.

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<sup>86</sup>Robert A. Schwartz, “The Trade-Through Rule Must Go”, *Securities Industry News*, February 14, 2005.

<sup>87</sup>Benn Steil, “The End of History and the Last Trading System, Fukuyama Comes to Market Reg”, *Securities Industry News*, March 28, 2005.

The so-called 'dark pools' along with other innovations provide automated ways for traders to execute their trades better, faster, and cheaper. The exchanges themselves facilitate this selective disclosure through their hidden order facilities.

In reality, there is no such thing as a truly 'dark pool' in the U.S. Immediately after a trade takes place in the U.S., the lights are turned on and the entire world can find out the price and quantity of the trades within seconds. This last sale information is extremely important in price discovery.<sup>88</sup>

In an academic study on equity trading in the 21<sup>st</sup> Century,<sup>89</sup> Professor Angel, Professor Lawrence E. Harris (Fred V. Keenan Chair in Finance, Professor of Finance and Business Economics, Marshall School of Business, University of Southern California, and Chief Economist of the SEC from July 2002 through June 2004), and Professor Chester S. Spatt (Pamela R. and Kenneth B. Dunn Professor of Finance, Director, Center for Financial Markets, Tepper School of Business, Carnegie Mellon University, and Chief Economist of the SEC and Director of its Office of Economic Analysis from July 2004 through July 2007), wrote:

"Brokers and others have developed many alternative trading systems to help large traders arrange trades and enhance liquidity provision, while protecting these traders from front-running and quote-matching problems that arise when information about their orders is widely known. Larger traders are anxious to protect the intellectual property and privacy of their trading plans. In a trading floor context, these trades previously used floor brokers who worked their orders based on their experience. Now many large traders use dark pools instead."<sup>90</sup>

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Several prominent legislators in the U.S. have recognized the value and role played by dark pools. In a letter to SEC Chairman Mary Schapiro, Democratic Senator Charles Schumer wrote,

". . . I recognize the important role that certain ATSs fulfill by executing large block orders on behalf of institutional investors in a non-display environment,

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<sup>88</sup> Letter dated April 30, 2010 from James J. Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University, McDonough School of Business, <http://www.sec.gov/comments/s7-02-10/s70210-172.pdf> (accessed June 14, 2011), pp. 6-7.

<sup>89</sup> James J. Angel, Lawrence E. Harris, Chester S. Spatt, "Equity Trading in the 21<sup>st</sup> Century", February 23, 2010, <http://www.knight.com/newsroom/pdfs/EquityTradinginthe21stCentury.pdf> (accessed June 14, 2011) ("Angel, Harris and Spatt").

<sup>90</sup> Angel, Harris and Spatt, p. 35.



and I would urge the Commission to consider an exception to the one-percent threshold as may be necessary to facilitate such block execution services.”<sup>91</sup>

Democratic Senator Jack Reed noted at a US Senate subcommittee hearing on market structure that,

“Dark pools and other undisplayed forms of liquidity have been considered useful to investors moving large numbers of shares since it allows them to trade large blocks of shares of stock without giving others information to buy or sell ahead of time.”<sup>92</sup>

Republican Senator Bob Corker similarly noted at the hearing:

“... it seems to me that the dark pools are an outgrowth of electronic exchanges where people are trying to sell large blocks of shares in a way that used to be done by individuals, so if we’re going to be almost all electronic exchanges ... what is another mechanism for large institutional traders with large blocks of stock? What is a fairer way for them to be able to make those types of trades without moving the market substantially and really harming the very people they’re investing for? What is a better mechanism than a dark pool?”<sup>93</sup>

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The National Investor Relations Institute, the largest professional investor relations association in the world representing 2,000 publicly held companies,<sup>94</sup> wrote similarly in response to the SEC’s Concept Release:

“In today’s market structure, dark pools provide an important function for investors by allowing large block trading with efficiency and anonymity. NIRI urges the SEC to proceed with a thorough understanding of dark pools’ price discovery role. If, for example, the proposed changes result in advantages to short term traders at the expense of long term investors, this does not foster fair, free markets for all participants in keeping with the SEC’s mission and investor protection role. We appreciate the SEC’s focus on large block orders by

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<sup>91</sup> Letter dated October 20, 2009 from Senator Charles Schumer to Chairman Mary Schapiro, [http://schumer.senate.gov/new\\_website/record.cfm?id=316252](http://schumer.senate.gov/new_website/record.cfm?id=316252) (accessed June 14, 2011), p. 4.

<sup>92</sup> Transcript of the Hearing of the Securities, Insurance and Investment Subcommittee of The Senate Banking, Housing and Urban Affairs Committee on “Dark Pools, Flash Orders, High Frequency Trading and Other Market Structure Issues,” October 28, 2009, pp. 1-2 (“Senate Subcommittee Hearing Transcript”).

<sup>93</sup> Senate Subcommittee Hearing Transcript, p. 36.

<sup>94</sup> For more information regarding NIRI see <http://www.niri.org/FunctionalMenu/About.aspx> (accessed June 14, 2011).

considering appropriate exceptions to facilitate execution of these large block orders. We also recommend the SEC continue to provide sufficient market flexibility to enable efficient execution of these types of orders.”<sup>95</sup>

## Canada

In November 2010, the Canadian Securities Administrators (CSA) and Investment Industry Regulatory Organization of Canada (IIROC) issued a joint consultation paper on “Dark Liquidity in the Canadian Market.”<sup>96</sup> In response to the 2010 Joint CSA/IIROC Consultation Paper, buy-side commenters were uniform in their support for systems that execute large orders, thereby reducing market impact costs.

The Buy-Side Investment Management Association Inc. (BIMA), a peer group of Canadian buy-side traders and trading department managers,<sup>97</sup> wrote:

“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.”<sup>98</sup>

BIMA wrote further:

“We also are 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.”<sup>99</sup>

The Portfolio Management Association of Canada (PMAC) represents 140 portfolio management companies that manage more than \$750 billion in assets for over one million institutional and private clients.<sup>100</sup> PMAC wrote similarly:

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<sup>95</sup> Letter dated February 16, 2010 from Jeffrey D. Morgan, CAE, President and CEO, National Investor Relations Institute, <http://sec.gov/comments/s7-24-09/s72409.shtml> (accessed June 14, 2011), p. 2.

<sup>96</sup> “Joint Canadian Securities Administrators / Investment Industry Regulatory Organization of Canada Consultation Paper 23-405 – Dark Liquidity in the Canadian Market”, November 19, 2010, [http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa\\_20101119\\_23-405\\_dark-liquidity.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20101119_23-405_dark-liquidity.pdf) (accessed June 14, 2011).

<sup>97</sup> For more information regarding BIMA, see <http://www.bima.ca> (accessed June 14, 2011).

<sup>98</sup> Letter dated January 10, 2011 from Milos Vukovic and Carol-Ann Banahan, Buy-Side Investment Management Association, [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110110\\_23-405\\_vukovicm\\_banahanc.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110110_23-405_vukovicm_banahanc.pdf) (accessed June 14, 2011), p. 2 (“BIMA 2011 Letter”).

<sup>99</sup> BIMA 2011 Letter, p. 3.

<sup>100</sup> For more information regarding PMAC, see <http://www.portfoliomanagement.org> (accessed June 14, 2011).



“As the Position Paper states, we believe it is reasonable for large orders to be exempt from pre-trade transparency. Such orders, if exposed to the market, could have a substantial price impact.”<sup>101</sup>

TD Asset Management Inc., a Canadian asset manager,<sup>102</sup> wrote:

“It is important for large asset managers to have a variety of tools at their disposal, including Dark Pools and Dark Orders, to trade large blocks of securities without information leakage to the marketplace.

. . . .

In our view, Dark Pools generally benefit investors by reducing trading costs, providing additional trade execution alternatives, and encouraging innovation and competition among trading venues. . . . Absent any substantive evidence, we urge the CSA and IIROC to take a deliberate and measured approach to regulating Dark Pools and Dark Orders as otherwise, unintended consequences could fundamentally alter or potentially eliminate the Dark Pool alternatives.”<sup>103</sup>

Connor, Clark & Lunn Investment Management Ltd., a Canadian asset manager,<sup>104</sup> described the value of dark pools for executing block orders:

“As we stated in our previous submission, we believe dark pools have served an important function in the market by facilitating the direct interaction between large investors. Dark pools have enabled investors to provide and source liquidity without directly disclosing order information in the quotes or to a broker, behaviors that could have substantial and adverse price consequences. For this reason, they have been a complement (not a replacement) to other execution venues in the Canadian market.

. . . .

Imagine a scenario in which a block order was published in full in the lit market. The price impact associated with such publication could be far beyond what an investor would pay managing the order in the upstairs market. As a result,

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<sup>101</sup> Letter dated January 10, 2011 from Katie Walmsley, President, PMAC, and Mark Pratt, Chair, Industry, Regulation & Tax Committee, AVP Legal, Mackenzie Investments, [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110110\\_23-405\\_walmsleyk\\_prattm.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110110_23-405_walmsleyk_prattm.pdf) (accessed June 14, 2011), p. 2.

<sup>102</sup> For more information regarding TD Asset Management Inc., see [http://www.tdassetmanagement.com/Content/Businesses/p\\_BusinessesHome.asp](http://www.tdassetmanagement.com/Content/Businesses/p_BusinessesHome.asp) (accessed June 14, 2011).

<sup>103</sup> Letter dated January 10, 2011 from Kevin LeBlanc, CFA, Chief Operating Officer, TD Asset Management Inc., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110110\\_23-405\\_leblanck.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110110_23-405_leblanck.pdf) (accessed June 14, 2011), pp. 1, 5.

<sup>104</sup> For more information regarding Connor, Clark & Lunn Investment Management Ltd., see [http://www.cclgroup.com/Corporate\\_Overview.aspx](http://www.cclgroup.com/Corporate_Overview.aspx) (accessed June 14, 2011).

without the upstairs market, such large orders simply wouldn't exist. The upstairs block market does not reduce the transparency on the lit market because these orders would never be sent to the lit market to begin with. Thus there is no cost associated with a reduction in transparency and there is a clear transaction cost benefit to investors."<sup>105</sup>

CNSX Markets Inc., an exchange operator in Canada,<sup>106</sup> echoed the position of the Canadian buy-side on this point. CNSX Markets wrote:

"In the various debates around dark trading, there has been one area of consensus: the need to accommodate the trading of large orders. There are market impact costs associated with trading such orders in public books that affect the sender as well as others in the markets at and around the time the orders are entered."<sup>107</sup>

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In December 2009, the CSA and IIROC issued a joint consultation paper on "Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada."<sup>108</sup> Buy-side firms and buy-side trade groups responding to the consultation paper consistently and uniformly identified the value of dark pools for executing block orders.

The Investment Counsel Association of Canada (now the Portfolio Management Association of Canada), wrote as follows in its comment letter on the 2009 Joint CSA/IIROC Consultation Paper:

"Dark Pools serve an important function in the marketplace – ICAC believes that there is, and has always been, a need and a role in the marketplace for hidden (i.e. non-displayed) liquidity. With effective and efficient regulation, Dark Pools support the objective of best execution for investors."<sup>109</sup>

TD Asset Management Inc. wrote similarly:

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<sup>105</sup> Letter dated January 17, 2011 from Don Towers, Partner, Head of Equity Trading of Connor, Clark & Lunn Investment Management Ltd., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110117\\_23-405\\_drakej\\_towersd.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110117_23-405_drakej_towersd.pdf) (accessed June 14, 2011), pp. 4 and 6.

<sup>106</sup> For more information regarding CNSX Markets Inc., see <http://www.cnsx.ca> (accessed June 14, 2011).

<sup>107</sup> Letter dated January 10, 2011 from Ian Bandeen, CEO, CNSX Markets Inc., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20110110\\_23-405\\_bandeenm.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20110110_23-405_bandeenm.pdf) (accessed June 14, 2011), p. 3.

<sup>108</sup> "Joint Canadian Securities Administrators / Investment Industry Regulatory Organization of Canada Consultation Paper 23-404 – Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada", December 15, 2009, [http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa\\_20091002\\_23-404\\_consultation-paper.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20091002_23-404_consultation-paper.pdf) (accessed June 14, 2011).

<sup>109</sup> Letter dated December 22, 2009 from Katie Walmsley, President, and Mark Pratt, Chair, Industry, Regulation & Tax Committee of the Investment Counsel Association of Canada, Senior Legal Counsel, Mackenzie, [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20091222\\_23-404\\_walmsleyk.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20091222_23-404_walmsleyk.pdf) (accessed June 14, 2011), pp. 2-3 ("ICA Letter").



“It is important for large asset managers to have at their disposal, a variety of tools, including Dark Pools and Dark Orders, to trade large blocks of securities without information leakage to the marketplace. In this regard, Dark Pools and Dark Orders benefit investors and our markets generally in many important ways by lowering trading costs, providing market participants more choice, and spurring competition among trading venues.

....

Qualitatively, the positive attributes to Dark Pools include order anonymity that results in reduced market impact and lower trading costs.

....

We believe that Dark Pools should not be required to provide pre-trade transparency of their orders based on a regulated threshold of trading activity, absent any measured benefit to mandating transparency to Dark Pools.

....

In our view, Dark Pools generally benefit investors and markets by reducing trading costs, providing market participants additional trade execution venues, and encouraging innovation and competition among trading venues.”<sup>110</sup>

Highstreet Asset Management, a Canadian investment manager,<sup>111</sup> wrote in its comment letter:

“Dark Pools provide two benefits; a forum to execute larger trades with less pre-trade information leakage; [and] more diversity in liquidity sources in that one is not locked to one broker for the order.”<sup>112</sup>

In its comment letter, Greystone Managed Investments, Inc., a Canadian investment manager,<sup>113</sup> focused on the importance of providing flexibility to the institutional trader in determining how to most efficiently execute a block order:

“Our submission therefore, takes the viewpoint of a large institutional investor. In this context, it is critical that we remain flexible in our trading decision to

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<sup>110</sup> Letter dated December 15, 2009 from Barbara Palk, CFA, President of TD Asset Management, Inc., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20091215\\_23-404\\_palk.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20091215_23-404_palk.pdf) (accessed June 14, 2011), pp. 2-4 (“TD Letter”).

<sup>111</sup> For more information regarding Highstreet Asset Management, see [http://www.highstreet.ca/who\\_we\\_are/index.html](http://www.highstreet.ca/who_we_are/index.html) (accessed June 14, 2011).

<sup>112</sup> Letter dated December 24, 2010 from Vidis Vaiciunas, Vice President, Head of Trading and Shaun Arnold, Chief Investment Officer of the High Street Asset Management, [http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com\\_20091224\\_23-404\\_vaiciunasv.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20091224_23-404_vaiciunasv.pdf) (accessed June 14, 2011), p. 2.

<sup>113</sup> For more information regarding Greystone Managed Investments, Inc., see <http://www.greystone.ca> (accessed June 14, 2011).

ensure we minimize market impact. Particularly for block trades, we need to minimize information leakage. As an institutional manager, we believe we need more flexibility and not less in deciding how we trade.

Institutional traders seek larger contras than are available in the displayed market. The largest cost of trading is the price impact of moving a large block of stock; therefore, greater flexibility is needed for institutional investors.

....

Institutions need full discretion on how to trade their block orders. Institutions need more flexibility and not less in deciding who can see their block order information. Institutions are in the best position to determine how to execute their holdings. Dark pools should not be required to provide transparency of their orders. This allows for institutional managers to maintain anonymity and minimize information leakage.”<sup>114</sup>

RBC Global Asset Management Inc., a North American-based asset manager with global scope,<sup>115</sup> wrote that use of dark pools is consistent with an investment manager’s best execution obligations:

“Investment managers have the fiduciary duty to obtain best execution for their clients. Therefore, the determination of how an order is executed is based on the investment manager’s evaluation of which marketplace (transparent or non-transparent) will help the investment manager meet this obligation. Further, investment managers are charged with controlling transaction costs in order to deliver the best performance possible to their clients; this responsibility includes considering the cost of market impact made by an order if sent to a transparent marketplace. As discussed in the Consultation Paper, there are clear benefits in using a dark pool. They do assist investment managers in reducing the market impact of placing a large order made on behalf of multiple clients, thereby accessing better execution.

....

As noted above, we generally use dark pools to trade orders that are particularly difficult to execute and to seek large blocks of liquidity while limiting the

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<sup>114</sup> Letter dated December 22, 2009 from Nadine Krenosky, CA, CFA, Chief Compliance Officer of Greystone Managed Investments, Inc., [http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com\\_20091224\\_23-404\\_krenoskyn.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20091224_23-404_krenoskyn.pdf) (accessed June 14, 2011), pp. 2-3 (“Greystone Letter”).

<sup>115</sup> For more information regarding RBC Global Asset Management Inc., see <http://www.rbcgam.com/gam/index.html> (accessed June 14, 2011).



leakage of trade order information to the market. As well, dark pools are used for price improvement.”<sup>116</sup>

Connor, Clark & Lunn Investment Management Ltd. wrote:

“As a general comment, we believe Dark Pools serve an important function in the marketplace, and, for the most part, we are not in favor of introducing significant restrictions on how these venues operate. Dark pools enable investors to provide and source liquidity without directly disclosing order information in the quotes or to a broker. For this reason, they are a complement - not a replacement - to other execution venues in the Canadian market.”<sup>117</sup>

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Commenters were specifically asked for their views on how dark pools affect market liquidity. In response to this question, the Investment Counsel Association of Canada (now known as PMAC), wrote:

“In our view, Dark Pools contribute positively to liquidity. If larger institutional investors can enter orders without fear of information leakage, then the hidden liquidity that exists on the desks and blotters of buy-side traders, or in their order management systems, is made available.”<sup>118</sup>

TD Asset Management Inc. wrote similarly:

“We expect liquidity to be enhanced by Dark Pools. We neither expect a material impairment on price discovery nor any excessive market fragmentation.”<sup>119</sup>

Greystone Managed Investments wrote:

“... the core benefit of dark pools is their ability to provide access to liquidity while minimizing market impact.”<sup>120</sup>

RBC Global Asset Management Inc. wrote:

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<sup>116</sup> Letter dated December 29, 2009 from Daniel E. Chornous, CFA of RBC Asset Management Inc., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20091229\\_23-404\\_chornousd.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20091229_23-404_chornousd.pdf) (accessed June 14, 2011), p. 2 (“RBC Letter”).

<sup>117</sup> Letter dated January 5, 2010 from Don Towers, Partner, Head of Equity Trading of Connor, Clark & Lunn Investment Management Ltd., [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20100105\\_23-404\\_towersd.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20100105_23-404_towersd.pdf) (accessed June 14, 2011), p. 2 (“Connor Clark Letter”).

<sup>118</sup> ICA Letter, pp. 2-3.

<sup>119</sup> TD Letter, pp. 2-4.

<sup>120</sup> Greystone Letter, pp. 2-3.

“Dark pools provide institutional investors with the ability to seek the type of liquidity they are looking for without experiencing undue market impact. They offer institutional investors the potential to find adequate contra-side trading interest for large, potentially market-moving orders, without affecting prices.

. . . .

As noted above, we generally use dark pools to trade orders that are particularly difficult to execute and to seek large blocks of liquidity while limiting the leakage of trade order information to the market. As well, dark pools are used for price improvement.”<sup>121</sup>

Connor, Clark & Lunn Investment Management Ltd. wrote:

“If anything, Dark Pools increase the liquidity available in the market by providing a way for investors to source liquidity that previously had only been available by calling a broker. Our desk is now able to find and provide liquidity without having to disclose any pre-trade information to a broker or the market as a whole.

. . . .

If the market share of Dark Pools in Canada were to increase, liquidity available in the market would also increase. Dark Pools can bring liquidity to the market that may not have otherwise come to the market.”<sup>122</sup>

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Consistent with these comments, TD Newcrest, a securities dealer in Canada that provides research reports on the equity markets, has noted in a research report that institutional traders in Canada,

“. . . remain concerned over information leakage that results from sophisticated pattern recognition as well as aggressive strategies utilised by high frequency traders that are able to maneuver in the market much more nimbly than traditional traders.”<sup>123</sup>

## **Australia**

In 2007, the Australian Securities and Investments Commission (ASIC) issued “Consultation Paper 86 – Competition for market services, trading in listed securities and related data.” (Consultation

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<sup>121</sup> RBC Letter, p. 2.

<sup>122</sup> Connor Clark Letter, p. 2.

<sup>123</sup> The Equity Division of TD Securities, “High Frequency Trading Strikes a Chord with Politicians, Regulators and Market Participants”, *S&P/TSX Bulletin*, p. 8.



Paper 86).<sup>124</sup> In Consultation Paper 86, ASIC requested comments from market participants on a series of market structure issues.

In response to Consultation Paper 86, the members of the institutional trading community in Australia wrote a joint letter discussing the problem of market impact costs and the role of block trading systems in addressing this problem:

“Pre-trade transparency is not desirable at all when executing large block orders. With regard to best execution, information leakage is an issue that is very costly to institutional investors and any ‘minimum condition’ that tries to force market participants to reveal their hand pre-trade goes clearly against best execution . . .”<sup>125</sup>

The institutional trading community in Australia noted further:

“The implicit costs of trading (sometimes referred to as ‘market impact costs’) are the costs of exposing a large order to a market that does not have sufficient liquidity to execute that order. Competition will give rise to alternative execution venues. Some of those venues will operate in a manner that protects the confidentiality of customer orders, resulting in significant transaction cost savings for Australia’s institutional investors and the millions of beneficiaries of the accounts that we manage.

Today, we rarely expose our full block orders to the public market and in many cases we do not show our full orders to our executing brokers. This is because of the potential market impact costs associated with information leakage from doing so. Alternative trading venues will provide new methods for our orders to interact, resulting in increased market liquidity. . . We do not believe that there is any need for pre-trade transparency for block trades as this would negate the primary benefit of a block trading system.”<sup>126</sup>

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ASIC has recognized the views of Australia’s institutional trading community on this issue. In a recently issued consultation paper on Australian equity market structure, ASIC wrote:

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<sup>124</sup> ASIC Consultation Paper 86 – Competition for market services, trading in listed securities and related data, [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/CP\\_86-Competition\\_for\\_market\\_services%20CP.pdf/\\$file/CP\\_86-Competition\\_for\\_market\\_services%20CP.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/CP_86-Competition_for_market_services%20CP.pdf/$file/CP_86-Competition_for_market_services%20CP.pdf) (accessed June 14, 2011).

<sup>125</sup> Letter dated August 17, 2007 from representatives of Australia’s institutional trading community to ASIC re: Consultation Paper 86 – Competition for market services, trading in listed securities and related data, [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Consultation\\_paper\\_86\\_submission\\_institutionalinvestors.pdf/\\$file/Consultation\\_paper\\_86\\_submission\\_institutionalinvestors.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Consultation_paper_86_submission_institutionalinvestors.pdf/$file/Consultation_paper_86_submission_institutionalinvestors.pdf) (accessed June 14, 2011), p. 3 (“Institutional Investors Letter”).

<sup>126</sup> Institutional Investors Letter, p. 3.

“There are some circumstances where pre-trade transparency can adversely impact a market and the investor in terms of price volatility and higher execution costs. For example, a large order can result in significant price movements, where other traders can act on the information before it is filled. In this context, having no pre-trade transparency (‘dark liquidity’) reduces the possibility of leakage and therefore lowers the costs of trading for these investors.”<sup>127</sup>

## IOSCO

In October 2010 the Technical Committee of the International Organization of Securities Commissions (IOSCO) published a Consultation Report on “Issues Raised by Dark Liquidity”.<sup>128</sup> In various sections of the Consultation Paper, IOSCO recognizes the value of dark pools for institutions seeking to execute block orders with reduced market impact.

IOSCO first explains that dark pools have arisen to facilitate “more effective” execution of institutional orders with “minimal market impact”:

“One such innovation is the expanded use of dark liquidity and the development of so-called *dark-pools*. Traders have always sought ways to preserve anonymity and execute orders with minimal market impact. Dark liquidity has long existed, for example, in the form of orders being held *upstairs [at] trading desks* and liquidity offered by firms that internalize their order flow. In recent years, the handling of dark liquidity has been made more efficient due to the use of new technology and trading models. This has resulted in, among other trends, significant growth in the number of dark pools that do not display any quotations.”<sup>129</sup>

IOSCO specifically enumerates some of the reasons why traders may use dark pools, including:

- “• to avoid information leakage;
- to minimize market impact costs;
- to facilitate the execution of large blocks which may be difficult to achieve on transparent markets due to a lack of depth in the orderbook;
- to ensure better control of an order;
- to protect proprietary trading information;

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<sup>127</sup>“ASIC Consultation Paper 145 – Australian equity market structure: Proposals,” November 2010, [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/cp-145.pdf/\\$file/cp-145.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/cp-145.pdf/$file/cp-145.pdf) (accessed June 14, 2011), p. 97.

<sup>128</sup> Technical Committee of the International Organization of Securities Commissions, Issues Raised by Dark Liquidity, Consultation Report, CR05/10, October 2010, <http://hb.betterregulation.com/external/Issues%20Raised%20by%20Dark%20Liquidity%20%E2%80%93%20Consultation%20Report.pdf> (accessed June 14, 2011) (“IOSCO Report”).

<sup>129</sup>IOSCO Report, p. 4.



- to avoid algorithms or programs that seek to identify or *sniff* out dark orders used in transparent markets;
- to take advantage of the possibility of price improvement; and
- to minimize transaction costs.”<sup>130</sup>

IOSCO further points out:

“[R]egulators must also keep in mind the trading interests of professional (i.e. non-retail) investors, who are primarily concerned about the costs of pre-trade transparency as they typically trade in very large sizes. It is these trading interests of professional investors that are often cited as one of the major reasons for the current interest in dark pools and dark orders.”<sup>131</sup>

In light of IOSCO’s recognition of the value provided by certain trading venues in facilitating the execution of large block orders, IOSCO provides the following guidance in the Consultation Report:

“The Technical Committee recognizes that different market segments have different trading needs depending on the type of order (e.g. large orders may incur market impact costs if subject to full pre-trade transparency obligations). The Technical Committee acknowledges these needs, and therefore suggests that it may be appropriate to have different levels of pre-trade transparency apply to different market structures or different order types.

Regulators may decide not to require pre-trade transparency for certain types of trading venues (e.g. call markets, reference-pricing venues or internal crossing systems/processes) or certain types of orders (e.g. large orders of institutional investors that do not wish such orders to be displayed).”<sup>132</sup>

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<sup>130</sup> IOSCO Report, p. 10.

<sup>131</sup> IOSCO Report, p. 15.

<sup>132</sup> IOSCO Report, p. 26.