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The Secretary Ontario Securities Commission
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M e Anne-Marie Beaudoin Corporate Secretary Autorité des marchés financiers
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Dear Sirs/Mesdames:

ITG would like to thank the Canadian Securities Administrators (CSA) for this opportunity to comment on the application of the Order Protection Rule when marketplaces impose systematic order processing delays.

While we always appreciate the opportunity to share our thoughts on pending regulation and market structure reform, we are surprised and confused that in this single instance comments are being sought after the commission has approved a controversial change, in a manner that was not properly contemplated during previous comment periods. Typically if the commission deems it necessary to significantly alter an offering that has been commented on, they will repeat the comment process to ensure such changes don't result in obvious harm to the market. We are concerned about the precedent set in this instance, and the significant challenges placed on market participants by rule changes that don't appear to be fully thought out.

Question 1: What are your views on whether OPR should apply to marketplaces that impose an order processing delay? If OPR should apply to marketplaces that impose an order processing delay, should it apply to some or all of them? What factors should be considered in determining whether OPR should apply to marketplaces that impose an order processing delay?

Question 1 quickly highlights one of our greatest concerns with the proposed policy. There is no actual definition of order processing delay. As laid out it would appear that a delay which is applied equally to all orders would be considered a delay, and result in said market losing order protection – even if said systematic delay was less that the delay at other markets. For example, should a Canadian market chose to delay all order in the manner that IEX does in the U.S., that market would be deemed non protected, even though the 350 micro second delay IEX uses is a fraction of the delay introduced by other markets that have intentionally not invested in leading edge technology. But our discussions with various regulators, throughout this comment process, lead us to believe that an IEX model would not be protected, but another market with greater overall latency, but no “systematic” speed bump would remain protected. We believe that marketplace protection should be based on the product offered, not the manner in which it is marketed.

Beyond that, the proposal highlights the delays at Aequitas Neo and Alpha, but does not consider delays at other markets. For example, the TSX has proposed a long life order that would systematically delay any resting order being CFO’d to aggress the spread. Should this intentional, well marketed, delay not also be cause to lose order protection? Likewise, the TSX engine currently introduces an extra hop for new orders, that is bypassed by cancellations and CFOs of existing orders. This results in said new orders experiencing systematic delays relative to other messages. Again we ask why these delays don’t result in a market losing protected status.

And what would the regulators do if a market decided to use geography to introduce delays? For example what if a market chose to place their matching engine in Vancouver, introducing 30 plus milliseconds of delay on any participants located in the Toronto area. Would that market remain protected? If not, how comfortable are regulators in the notion that Canadian markets must be located in Toronto?

The hybrid model, where some lit venues are protected and others are not, creates more issues than it solves. This is why we argued against such a model in the 2014 round of OPR commentary. With that in mind, should the regulators chose to go down this rabbit hole, it only makes sense to consider the impact of the processing delay, rather than bucket all markets with processing delays together. For example, a market where all orders are delayed offers no advantage to any one group of participants. This is very different from the Alpha model, which is wholly designed to allow liquidity providers to fade their orders when observing evidence of an oversized liquidity taker entering the market. We fail to appreciate why two very different usages would be considered identical for the purposes of this proposed rule.

Question 2: In an environment where not all displayed orders on visible marketplaces are protected under OPR because marketplaces impose an order processing delay, what are your views with respect to the outcomes for protected and unprotected visible marketplaces and for trading on those marketplaces?5 In responding, please consider the impacts on:

(a) various market participants including retail and institutional investors, and liquidity providers;
(b) liquidity on both protected and unprotected visible marketplaces;
(c) price discovery;
(d) complexities and changes you anticipate from participating in both protected and unprotected visible marketplaces, including costs and effort; and
(e) the provision and use of consolidated data.

Our response to this question is entirely predicated on yet to be seen guidance from regulators around the appropriate usage of non protected markets for agency flow, as well as what market designs the regulators now see fit for approval. To the extent that a hybrid model allows for the existence of venues like Alpha, designed to facilitate systemic fading of liquidity, then the hybrid model can only have a detrimental impact on retail and institutional investors trying to capture reasonable sized liquidity.

Beyond this, the complexity of our market will increase tremendously, and its attractiveness to occasional international users will deteriorate in kind. Investors that have become accustom to capturing the full stated quote will undoubtedly become frustrated as smart order routers are made less effective, and quoted liquidity becomes less relevant. This will heavily incent users to consider non Canadian markets when building or unwinding positions in products that are dually listed.

The allowance of locked and crossed markets will again increase complexity and confusion, while decreasing marketplace satisfaction amongst real investors.

Locked markets create severe challenges for dark liquidity, which presents a perverse incentive for lit markets to create further non protected venues.

Dealers will need to rewrite large portions of their algo and SOR technology to handle locked markets, phantom liquidity, and other complexities that are allowed under the guise on unprotected markets. This will come at great cost, and effort to the dealer community with questionable benefits being derived by investors.

At the end of the day we are able to highlight significant costs that will be introduced into the market, but fail to appreciate any real benefits that will be derived by real investors.

Question 3: A key objective of OPR is to recognize and support the role of retail participation in the market. If the Proposed Amendments are finalized, what changes if any, do you expect will be required for dealers handling retail order flow? What changes if any, do you expect in terms of outcomes for retail clients?

While allowing venues to create mechanisms that facilitate systematic fading may create incentives for liquidity providers to quote more aggressively for retail clients, or at least quote on venues where the economics tilt towards retail dealers, we don’t believe the overall impact will be positive for retail investors.

Retail orders come in all shapes and sizes. Those larger orders, requiring dealers to capture liquidity on multiple venues will suffer from an inability to effectively capture the quote.

To the extent that increased complexity, and decreased investor satisfaction drives real flows away from the Canadian market, retail investors will suffer from less informed price discovery, and less depth of real liquidity.

During the original OPR comment process, Canadian regulators made it clear that an environment with no Order Protection Rule would make best execution monitoring too difficult, which they felt would ultimately harm retail investors. Best execution in a hybrid model, with markets operating that would otherwise not have been approved, is far more complex and far more likely to obfuscate best execution standards. We fail to appreciate how no OPR was deemed too complex for real consideration, but a far more complex hybrid model was passed before being subjected to a full comment process.

In conclusion, we are dismayed that the regulators have chosen to create a hybrid OPR regime via the Alpha approval, and then publish this request for comment. We believe that this comment period should have superseded the approval of any market mechanism that regulators weren't otherwise comfortable with.

The hybrid model, with it facilitation of liquidity fading and allowance for locked markets is a step backwards, both in terms of marketplace operation and perception. Markets should aspire to greater fairness and reduced intermediation, but this proposal seems to result in the exact opposite. And the application appears to be aimed at specific markets, despite the clear fact that other Canadian venues impose greater latency, or have latency asymmetries amongst users and order types.

As always, ITG appreciates the opportunity to share our perspectives, and participate in the regulatory process. We welcome the opportunity to explain our views in person with all interested regulatory bodies.

Sincerely,

Doug Clark
Managing Director,
ITG Canada