ITG Independent Trading Group

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Internalization Commentary May 2019

We would like to thank IIROC for delving into this issue which we consider to be of critical importance to the health and future viability of the Canadian Marketplace. We appreciate the opportunity to provide commentary on this subject as we see it.

Independent Trading Group (ITG) Inc. has been providing Liquidity to ALL market participants on a constant and consistent basis for over 20 years. We feel particularly qualified to comment on this subject and on the overall health of the Canadian Market.

For the purpose of this Consultation, we consider Internalization to mean any order captured and crossed before exposure to the marketplace, for any benefit of the broker delivering the order. Either Direct (spread capture) or Indirect (cost savings). Broker Preferencing is one mechanism which allows this behavior to take place. Based on our status of providing liquidity to ALL market participants, we feel this practice is insidious as it deprives already posted orders, waiting in queue, of the ability to receive a fill. Price discovery is compromised by this practice. And a competitive market is circumvented, to the detriment of ALL Market Participants. Broker Preferencing has become the thin edge of the wedge for some to firms to promote more systematic internalization. We believe it is time to go back to the basics. The simple process of posting an order, is of critical importance to the proper functioning of markets. In our opinion, intercepting any order before it is exposed to a Marketplace contradicts all of the tenets of a fair and open Marketplace. Dark orders are traded through. Posted orders are deprived of a fill and are not rewarded for taking the risk of posting a market. It becomes a question of risk. Market Participants, especially those with Marketplace Obligations, are taking a risk posting markets; for the benefit of ALL Participants. If this risk is not rewarded, or worse taken advantage of by using it as a pricing mechanism, with no reward of a fill, fewer and fewer orders will be posted. The result is less commitment to posting orders in the lit book, depriving ALL Participants of liquidity. Posting orders in the dark markets to offer price improvement to all participants, and not act as a pricing mechanism for Internalizers, is not desirable as it diminishes the depth of the lit book. Creating an order to take advantage of an order via broker preferencing is particularly harmful and contrary to the spirit of the Trading Rules. We feel this is abusive behavior, taking advantage of the handling brokers place in the price discovery mechanism, and is a violation of the spirit of Trading Rules. Market Quality must continue to be a concern, and needs to be protected by the Regulators, as market share of Canadian stocks trading in Canada continues to erode.

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We would like to take this opportunity to dispel some erroneous notions.

- Price Improvement justifies queue jumping. Dark orders are essentially lit orders that have been chased from the lit market in order to counter the effects of Internalizing and Broker Preferencing. This indicates that current minimum tick requirements for price improvement is not enough of a threshold to justify queue jumping. A one cent improvement, often times significantly less than that with dark fills, is too low a threshold as it disenfranchises posted orders and trades through dark orders.

- Clients want a fast fill. If one explained to clients the cost of expediency vs more balanced liquidity results in their forgone revenue collectively, over time clients may prefer the benefit of market prices vs a fast fill. Opening the door to internalization will not give them this choice.

- Costs will increase. Internalization and Broker Preferencing reduces competition among brokers and acts as a barricade to new entrants looking to trade our market. We feel strongly that the cost involved in maintaining a robust, healthy and relevant Canadian Capital Market must be considered against the cost savings of particular dealers implementing internalization systems in their sole self-interest.

Internalizers suggest they enhance liquidity. As Market Makers, we understand our obligation is to provide liquidity to ALL participants. At all times. Internalizers only take advantage of orders they are certain they can unwind at a profit. Any order with a modicum of risk attached, is released to the market. They are liquidity providers at their convenience. And non-desirable orders are turned over to a liquidity depleted Book.

Solutions? No longer can an order be created to take advantage of an incoming client order. If the Internalizing firm has an already existing client order in the book - to be determined by a previously resting time threshold - it may cross a portion of the order. Part of the order should trade with orders that establish the price, part should trade with the market maker, and part should trade with better priced dark orders. This would bring back meaning and integrity to the market. A truly competitive market. Orders would be more willing to be disclosed if they would receive some reward for the risk they have assumed, by participating in the price discovery mechanism.

There is a definite divide between large firms and small firms on this issue. It is imperative that the Regulators take ownership of this issue and create a framework that Makes the Market Matter for the long-term benefit of all Investors. For Internalizers to suggest they would seek out alternate arrangements to crossing flow is disingenuous. Taken further, why even bother having a Capital Market in this Country. A series of crossing networks would suffice according to some Participants.

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The Independent Dealers play a critical role in capital formation and risk assumption for all but the largest corporate entities in this Country. To exclude these Dealers and their intellectual property from the price discovery mechanism is a huge mistake and threatens the very existence of the Capital Markets in this country.

Ultimately, Making the Market Matter must be the primary concern of the Regulators. The integrity of the Marketplace must be defended. If not, it is very likely we will not have a relevant Capital Market in this country. And that cost would be too great for ALL Participants to pay.

We would be happy to discuss this topic further, please do not hesitate to contact us.