



CANADIAN SECURITY TRADERS ASSOCIATION, INC.

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Market Regulations Branch
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and

Mark Faulkner
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Re: CSE Notice 2016-14 – Significant Change Subject to Public Comment – Amendments to Trading System Functionality & Features – Notice and Request for Comment

The Canadian Security Traders Association, Inc. ("CSTA") is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling and trading of securities (mainly equities). The CSTA represents over 850 members nationwide, and is led by volunteer Governors from each of three distinct regions (Toronto, Montreal and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world.

This letter was prepared by the CSTA Trading Issues Committee (the "Committee", "CSTA TIC" or "we"), a group of 20 appointed members from amongst the CSTA. This committee has an approximately equal proportion of buy-side and sell-side representatives with various areas of market structure expertise. It is important to note that there was no survey sent to our members to determine popular opinion; the Committee was assigned the responsibility of presenting the views of the CSTA as a whole. The views and statements provided below do not necessarily reflect those of all CSTA members or of all members of the Trading Issues Committee.

The CSTA TIC appreciates the opportunity to comment on the proposal by the Canadian Securities Exchange ("CSE") to introduce a Guaranteed Minimum Fill ("GMF") Market Maker Participation feature to the CSE's market making model (the "Proposal").

CSE MM Participation Proposal Should Not be compared to TSX RT Participation

In its Proposal, the CSE attempts to present the GMF Market Maker ("MM") Participation feature as similar to the existing TSX Registered Trader ("RT") Participation feature. We disagree with CSE's claim that the Proposal is something that "already exists in Canada and is currently provided by one or more marketplaces". Rather, we believe that the CSE's proposed MM Participation feature carries significant material differences from the existing TSX RT Participation feature and thus should be considered as separate and distinct without specific precedent in Canada.

Under the Proposal, the CSE would permit the MM to optionally auto-trade up to 40% of board lot volume of any incoming active order deemed GMF-eligible. In the case of an incoming active order for two boards deemed GMF-eligible, the MM's participation would increase to 50% (one board lot). In the case of an incoming active order for one board lot deemed GMF-eligible, the MM's participation would increase to 100% of the order (one board lot). The Proposal is in stark contrast with the TSX RT Participation feature, which when enabled, obligates the TSX Registered Trader to interact with a portion of all market-bound active flow, and not only MGF-eligible ("retail") flow. Note: we do not necessarily believe that the TSX RT Participation feature appropriately balances the necessary obligations in order to provide the associated benefited to the MM involved.

We are concerned that CSE's Proposal insufficiently explains the substance of these differences. At minimum we recommend the proposal be updated and republished for comment, including trading examples that illustrate how the proposed MM participation will work, enabling greater transparency of the CSE's operations.

CSE MM Participation Circumvents the Dark Rules to Intermediate Retail Orders

In the context of the CSE's GMF facility, the orders which are deemed GMF-eligible are those which are not part of a larger orders, not directed by a DEA client (unless the DEA client is executing retail flow), not entered on behalf of a US dealers and not for a client that is generally involved in trading on a daily basis. For all intents and purposes, we believe that the definition of GMF eligibility is designed to describe retail flow to the exclusion of directional institutional orders and order flow from professional market participants such as high frequency intermediaries.

The Proposal contemplates that the CSE MM would be able to utilize FIX messages to specify the maximum participation volume, the participation rate, total maximums tradable, and the side on which they wish to receive fills. The CSE MM would also have the ability to electronically turn on or off the Participation feature which permits them to trade alongside resting orders only when the active party is GMF-eligible and by extension retail in nature. If the CSE's existing resting orders are insufficient to fill the incoming active GMF-eligible ("retail") order, the MM would then internalize the retail order as a Guaranteed Minimum Fill. However, if an incoming active order is non-retail (non-GMF-eligible), the CSE market maker would avoid interacting with the active order, because the participation feature is constrained to GMF-eligible orders.

We believe that the CSE MM Participation proposal at hand circumvents the letter and the spirit of Canada's rules governing non-displayed liquidity (the "Dark Rules"). By permitting a CSE MM to secretly enable or disable a feature on a single side of the market, specifying both maximum fill size and total maximum order size, the CSE is effectively permitting the MM to enter non-displayed orders equivalent to "interacting with retail orders only." This type of order is equivalent to an undisplayed order which is constrained to only trade with retail orders.

Since the CSE's proposed GMF Participation feature provides no price improvement and the CSE MM is able to trade before all lit volume is exhausted, we believe that this violates two key principles of Canada's dark rules:

- 1) Dark orders must offer meaningful price improvement over the NBBO
- 2) Marketplaces must provide priority to lit orders over dark orders

We also believe that the CSE's proposed GMF Participation would worsen existing conditions related to the segmentation of retail order flow by allowing a select counterparty (a MM chosen by the CSE for each stock) to internalize flow to the exclusion of all other participants who may be resting orders in the market.

We also disagree with CSE's claim that "the new features encourage greater liquidity to the benefit of all market participants". The benefits of the CSE proposal (if any) are targeted to a specific segment of the trading community (the CSE's designated market makers), and in fact there are clear disadvantages in the Proposal for participants that would post orders on CSE, including protected orders in CSE listings.

For the above reasons, we believe the CSE's proposed GMF Participation feature should be denied.

Thank you for your attention in this matter.

Respectfully,

"Signed by the CSTA Trading Issues Committee"

c.c. to:

Ontario Securities Commission:

Ms. Maureen Jensen, Chair & CEO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

Alberta Securities Commission:

Ms. Lynn Tsutsumi, Director, Market Regulation

Autorité des marchés financiers:

M^e Éline Lanouette, Directrice des bourses et des OAR

British Columbia Securities Commission:

Mr. Mark Wang, Director, Capital Markets Regulation

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Mr. Andrew Kriegler, President and CEO
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