CANADIAN SECURITY TRADERS ASSOCIATION, INC.
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September 10th, 2018

Market Regulations Branch
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and

Mark Faulkner
Vice President, Listings and Regulation
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Re: Canadian Securities Exchange -- Significant Change Subject to Public Comment (August 9, 2018)

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 four distinct regions (Toronto, Montreal, Vancouver and the Prairies). 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 appointed members from amongst the CSTA. With 21 members, this committee seeks an 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 appreciates the opportunity to comment on the proposal by CNSX Markets Inc. to introduce new order types to the Canadian Securities Exchange. We focus our commentary on two specific topics:

the introduction of a “Max Quantity” pegged order feature, and the introduction of broker preferencing for non-attributed dark orders.

Max Quantity Dark Pegged Orders

The proposed Max Quantity Dark Order type feature would permit users to stipulate that a particular passive dark order would only interact with an active order of a specified maximum size. This feature effectively allows a participant to bypass executing against large orders with legitimate trading interest in order to benefit from receiving fills from only small, “benign” order flow. This is reminiscent of the size discriminating benefit that DMMs receive as one of the tradeoff’s for having fill obligations under the TSX and CSE guaranteed fill facilities for which only small “retail” orders are eligible. This proposed order type feature does not purport to have any associated obligations to having such a valuable size discrimination benefit, and thus does not even attempt at balancing the reward.

Other than guaranteed fill facilities, order types and features that allow for size discrimination in Canada generally seek to disallow small orders from interacting from large orders in order to minimize information leakage and the potential for gaming of large orders. This use if minimum order size discrimination is globally accepted as beneficial to the market. With regards to maximum fill quantities, some may argue that providing a feature to participants that allows them to protect themselves against adverse selection from large orders may allow small orders the option to get price improved fill that they may not have otherwise received. We do not believe that this benefit compensates for the advantage that the max quantity users will have by bypassing large orders from investors that have bona fide trading interest, and the impact that this has to market integrity and potentially market quality. Allowing a precedent of this nature would allow every marketplace to create their own versions of a dark max quantity order type. We believe this would result in less available liquidity for large orders, making it even more difficult to manage large order footprints.

Note that the Aequitas Neo Exchange had originally proposed a similar large size discriminating feature for their own listed securities via the Market Maker Commitment (MMC)[1]. On September 5th, 2014, the CSTA TIC commented on feature[2], suggesting that the feature was inappropriate and should be removed. Aequitas agreed and dropped it from its final Trading Policies. NYSE Arca also decided to discontinue a max quantity feature of its PL Select order type due in part to institutional investors’ concerns. [3]

The proposed max quantity feature also allows for leakage of non-public information. If a participant uses the max quantity feature with a midpoint pegged order, the mere fact of not receiving a fill at the midpoint when the CSE lit book receives a fill at the touch will indicate to the participant (and only to that participant) that an order larger than the max quantity is in the market (or less probably that a bypass order was used). Inferring that a large order is in the market as a result of not receiving a fill provides an

[1] Proposed Aequitas Trading Policies, (Section 10.03, (2), d), iii), d)
http://www.osc.gov.on.ca/documents/en/Marketplaces/xxr-aequitas_20140627_nrfc-application2.pdf

[2] CSTA TIC – Response to Recognition of Aequitas as an Exchange - Letter dated September 5th, 2014, p.7, q. 2
http://www.osc.gov.on.ca/documents/en/Marketplaces/com_20140905_canadian-security-traders-association.pdf

[3] https://www.sec.gov/rules/sro/nysearca/2012/34-68385.pdf

advantage without forcing participants to take on trading risk. This advantage is further exacerbated in situations where orders are routed sequentially.

Finally, we believe that users seeking to avoid interaction with large order flow already have a simple tool at their disposal: they can simply reduce their order quantities to a suitably small size. Allowing order types that allow a user to specify max quantities would substantially increase market structure complexity for no notable value add to the marketplace.

For the above reasons, we believe the CSE's proposal to introduce a Maximum Quantity order type feature should be denied.

Broker Preferencing for Non-Attributed Dark Orders

We believe the topic of priority to non-attributed orders should be examined in the context of the broader application of attribution in Canada. While we acknowledge that anonymous broker preferencing currently exists on other marketplaces in Canada, we believe that both existing applications and the new proposal should be equally examined.

Broker priority and anonymity were concepts that were introduced and pioneered in Canada subsequent to the Toronto Stock Exchange's move to electronic order matching. To this day, the principle observed in all lit markets supporting broker preferencing is to limit the benefit to those orders willing to attribute their broker code, pre- and post-trade. This represents a trade-off: if a participant wishes to gain the benefits of anonymity, they forego the benefits of attribution. To the extent that the attribution of orders in the market is seen as a benefit to the marketplace as a whole, anonymity takes the benefit away, and therefore participants wishing to be anonymous give up something in return. We believe that this trade-off has fundamentally been viewed as fair by many market participants.

The proposal from CSE contemplates doing away with this trade-off and offering the benefits of anonymity and attribution at once. We note that the benefit of broker priority exists whether or not pre-trade transparency is offered and therefore should be considered more broadly than simply in the context of pre-trade transparency. The "fairness" argument above can apply to all marketplaces, lit and dark.

To the extent that transparency is seen as a public good, we believe that choices made by a participant to limit the transparency offered to others (such as anonymity) should come at some cost (such as giving up broker priority). Based on the above view of the trade-off between broker preferencing and broker attribution, we believe the CSE proposal to extend broker preferencing to unattributed orders should be denied. We also recommend that other Canadian dark markets offering anonymous broker preferencing be required to make corresponding changes.

We appreciate the opportunity to discuss this proposal. 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^ Élaine Lanouette, Directrice principale de l'encadrement des structures de marché

British Columbia Securities Commission:
Mr. Mark Wang, Director, Capital Markets Regulation

IIROC:
Mr. Andrew Kriegler, President and CEO
Ms. Victoria Pinnington, Senior Vice President, Market Regulation
Mr. Kevin McCoy, Vice-President, Market Regulation Policy
MS. Sonali GuptaBhaya, Director, Market Regulation Policy