CANADIAN™ SECURITIES EXCHANGE

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BY EMAIL

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RE: CSA/CIRO Staff Notice 23-331 Request for Feedback on December 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets

CNSX Markets Inc., operator of the Canadian Securities Exchange (CSE), thanks the Canadian Securities Administrators (CSA) and the Canadian Investment Regulatory Organization of Canada (CIRO) for the opportunity to provide feedback on CSA/CIRO Staff Notice 23-331 – *Request for Feedback on December 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets* (23-331 or Joint Notice). Unless otherwise indicated, we have used the same defined terms as 23-331.

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We would first like to commend the staff involved in the preparation of the Joint Notice for their careful analysis of the SEC Proposed Amendments and we appreciate the thoughtfulness that has gone into the questions posed in 23-331. We would also like to express our appreciation for the work that is going in to ensuring that the regulatory regime in Canada is responsive to changes in cross border capital markets.

We share your assessment that the SEC Proposed Amendments relating to Best Execution and Order Competition do not materially impact Canadian capital markets and do not require any changes to the Canadian regulatory regime. We also have no strong views on Access Fee Caps and feel we are well suited to adapt to any regime adopted in Canada that suits market participants, and as such, will not address this in our response.

If the SEC were to move forward with the proposed amendments to Variable Minimum Pricing Increments, or tick sizes, for National Market System (NMS) securities, such an amendment would warrant a closer review by Canadian regulatory authorities. As the listing exchange of choice for several inter-listed securities, we believe that we are well positioned to provide our comments as they relate to the potential impact that we believe a change to tick size could have on our inter-listed issuers.

Below we provide our analysis of the potential impact of tick size changes by looking at CSE listed issuers that already trade in smaller tick increments on the US OTC marketplace. We also answer your Questions 1-6 in Appendix A attached.

Tick Size Analysis

To determine whether there is a clear competitive advantage across trading jurisdictions (Canada and US) to offering a lower tick increment in Canadian securities already trading at their smallest tick increment, we analyzed the universe of CSE securities that:

1. Exhibit the tightest possible spread allowed in Canada for their price range measured by a Time-Weighted Average Spread over our period of analysis; and

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2. Trade on the US OTC marketplace at <$1 where there is already a smaller tick increment ($0.0001) for these securities.

In our analysis, we looked at the breakdown of traded volume to see where most of the trading occurs as if there is a clear advantage to having a smaller tick increment, then this should manifest by more volume trading on the US OTC for these symbols than in Canada. We note that this may be different for higher priced securities.

Our analysis determined that there were 97 CSE symbols that trade at the tightest spread possible in Canada (somewhat analogous with tick-constrained), with 91 of them having a volume-weighted average price (VWAP) over the analysis period of <0.50c, and 6 having a VWAP of >= 0.50c and <$1. 77 of these securities also traded on the US OTC marketplace over the period of analysis. For these 77 symbols the Canadian market share is 83% vs 17% for the US OTC marketplace. As an additional note, the CSE does not have a Market-on-Close, so there is no significant volume occurring at the close that would not be possible to execute in the US.

Although the conclusions of this analysis would not necessarily apply equally to higher priced securities or those included in indices (such as many of those on the TSX), it does highlight that, at least for CSE listed securities trading at their minimum tick, where a lower tick increment is already available in the US marketplace, there does not appear to be a significant benefit to one jurisdiction over another.

Conclusion

The CSA and CIRO should balance the risk of increasing levels of complexity due to smaller tick increments and the cost of syncing up tick increments with the US market tick-sizes with the potential benefits of doing so. The SEC proposal on tick-increments is largely intended to improve order-by-order competition in the US. Broadly, this is not a problem in the Canadian market, and we should carefully consider making any changes to our market structure that is not intended to solve a Canadian problem or make the Canadian market more efficient.

The CSE recommends adopting a wait-and-see approach to tick-sizes in Canada, keeping our current tick regime until after the US had adopted and implemented their policies. At that point, we will have more information on trading patterns to determine the correct course of action, and whether the cost of implementing a US style tick-sizing regime would be worthwhile. We do not think that waiting will negatively impact liquidity or fair and efficient trading on Canadian venues.

We would be pleased to work with and would welcome the opportunity to share our data with CSA and CIRO Staff on the issues raised in this comment letter as well as to discuss any of the points in the above or the attached Appendix.

Sincerely,

[redacted]

Stuart Schady
Vice-President, Trading and Market Data Services
[redacted]

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Appendix A

Specific Questions

Question 1: If adopted as proposed by the SEC, please provide your views regarding whether Canada should harmonize with an amended SEC rule, including with respect to:

(a) the methodology used to calculate minimum pricing increments, including, source of data (which marketplaces and what entity should be responsible for calculation) and time periods during which the metrics are calculated,

(b) securities to which any amended Canadian price increments would apply (e.g., inter-listed securities only or all or some classes of securities, exchange-traded funds and/or other exchange-traded securities),

(c) treatment of situations where the use of an aligned methodology results in different trading increments between inter-listed securities traded in Canada and the U.S. (i.e., where the time-weighted average quoted spreads in Canada and the U.S. are different for the same security).

CSE Response:

a) If Canada decided to proceed with a new methodology on minimum pricing increments then:

  i. The methodology should be identical to that adopted in the US on securities we believe should fall under this regime.

  ii. The Listing Exchange should be the source of the data.

  iii. Going back to the methodology, time periods should match those of the US.

b) There is a case to be made that amending the Canadian price increments in inter-listed securities may help maintain Canadian market competitiveness in those securities. However, given that it is not an obvious outcome and that the cost of doing so may outweigh the benefits, we suggest adopting a wait-and-see approach.

c) No comment.

Question 2: If Canadian requirements as related to minimum pricing increments are not amended in response to an amended SEC rule as proposed:

(a) Would marketplace participants send less order flow to Canadian marketplaces in favor of U.S. trading venues?
(b) Does the difference in value between the Canadian and the American dollars matter in your analysis?

CSE Response:

a) It may, but based on our analysis, at least for CSE securities largely in the below 50c price range where the security was tick-constrained in Canada and traded in smaller tick increments on the US OTC we found no meaningful evidence supporting this assertion.

b) We did not explicitly consider the exchange rate in our analysis.

Question 3: Concerns have been raised in relation to:

(a) operational resiliency and systems readiness should the number of pricing increments be increased, especially where they would be periodically adjusted on a per-security basis, and
(b) increase in message traffic (i.e., electronic order and trade messages) that will result from an increase in the number of pricing increments. Please discuss whether you share these concerns.

CSE Response:

a) The existing marketplace requirements would manage those risks and there does not seem to have been a huge increase in outages in the European Union once varying tick sizes were introduced under MiFiD II.

b) This is a legitimate concern and a hidden cost of decreasing the tick size increment. The cost would be applicable to any entity that received messages – dealers, vendors, marketplaces, and the regulators. When increments were tightened in the past there was a considerable increase in message traffic which was far larger than the proportional increase in trade volumes. This was seen across cash equities and further down the chain, on any market which relied on cash equities for pricing, such as options and ETFs. Before proceeding there should be an examination of the current market infrastructure to ensure it can handle this material increase in activity.

Question 4: It has been suggested that any Canadian proposal to amend minimum pricing increments would introduce complexity in managing orders. Please provide your views in this regard, including as related to:

(a) complexities associated with the frequency at which minimum trading increments could change,
(b) the necessary lead-time between establishment and implementation of new minimum trading increments both initially and on an ongoing basis,
(c) challenges with management of existing orders entered on marketplaces at prices that have become invalid trading increments (may be particularly relevant for orders of retail investors that are entered with longer expiry dates (i.e., "GTC" orders)),
(d) investor education challenges associated with an amended approach to minimum pricing increments.

CSE Response:

a) Once the system has been created to accommodate a regime of minimum trading increment changes like that implemented in the US, there is no reason why this could not be done daily. We do recommend that the Listing Exchange of the security should be the final word on the matter to prevent any discrepancies between marketplaces in Canada.

b) No comment.

c) This would already be a concern for securities that trade in 0.005c tick increments in Canada. However, having a smaller tick increment would exacerbate the problem.

d) Dealers and marketplaces would have to share in the need to educate investors about the workings of the market.

Question 5: As modifying trading increments in Canada would impact the determination of a "better price" under UMIR, please discuss whether Participants (as defined in UMIR 1.1) would still be providing meaningful price improvement in circumstances where a "better price" is required.

CSE Response:

The policy behind the determination of a 'better price' and the balancing of interests made at the time of implementation should be considered. If the regulators did not believe that fractions of a penny are providing price improvement (other than half cents in certain circumstances), then what would change that view in these circumstances? Would the benefits of accepting these smaller increments of price improvement outweigh any impact the market? Would the policy position that these increments are too small to be considered price improvement change?

Question 6: Please provide any views on expected outcomes (positive and negative) associated with any changes to minimum trading increments, including as related to expected quoted volume at each price increment. Additionally, please provide your views on what metrics could be used to evaluate whether any new approach to minimum trading increments results in positive or negative outcomes.

CSE Response:

In our view, the following is a list of potential negative outcomes:

1. Lower quoted volume at each price point (i.e. less depth at each price level).
2. Increased message traffic and therefore, increased cost and need for scalability.
3. Cost of changing (development) to a new tick regime to every industry participant (dealers, marketplaces, vendors, CIRO).
4. Measurement of price improvement is in increments of a penny – what is meaningful price improvement to investors?

A list of the potential positive outcomes:

1. Smaller tick increments in stocks that are tick-constrained which reduces trading frictions and thereby costs.
2. A competitive marketplace when compared to that of the US alternative.

Some potential metrics that could be used to determine the success of a new regime are:

1. Message traffic rates.
2. Average volume on the inside bid/offer vs current volume.
3. Traded volume analysis between the US and Canada on all Canadian listed securities.