



CANADIAN SECURITY TRADERS' ASSOCIATION, INC.

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RE: Request for Feedback on Dec 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets

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 Governors from each of four distinct regions (Toronto, Montreal, Prairies 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 CSTA Trading Issues Committee (TIC) 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 views and statements provided below do not necessarily reflect those of all CSTA members or of their employers.

The TIC appreciates the opportunity to comment on the proposed amendments and request for Request for Feedback on Dec 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets.

Regulation is bounded in its scope, but capital markets are porous, and liquidity flows across borders. Canadian capital markets are particularly porous given the large number of inter-listed issuers across Canada and the US. Any market structure change in one regulatory regime is highly likely to impact the other regulatory regime. Thus, if the SEC is proposing major market structure changes, it would be very risky for Canada not to do the same. For example:

If the SEC changes the minimum pricing increment and those changes lead to a superior NBBO in the US, Canadian brokers will point their order routers to take more liquidity from US marketplaces. Such actions will lower queue depletion rate on Canadian marketplaces and increase the delay cost of resting orders on in Canada. Trading will start to leave Canada and eventually even issuers may follow.

Short of implementing a full European style “share trading obligation” compelling Canadian investors to trade Canadian issuers on Canadian marketplaces (which we would strongly oppose) we don’t see any other option but to match the proposed SEC changes where applicable.

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,

Regulators should harmonize the minimum pricing increments, access fees and transparency of better priced orders (including odd lots) with the US regime irrespective of the source data and time periods used by the SEC. The SEC will likely only consider data from US marketplaces. Canadian regulators are likely to only consider data from Canadian marketplaces. It’s possible regulators will observe discrepancies across the two data sets for interlisted securities. In order to minimize any loss of regulatory “sovereignty” perhaps it would be beneficial for both regulators to harmonize their data set for inter-listed securities. If regulators can’t harmonize their data set, then Canadian regulators should apply the SEC data over the Canadian data.

(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),

The CIRO study identified 140 securities that were potentially “tick constrained” making up 39% of the traded volume and 16% of the traded value over the study period. Given the presence of an artificially wide bid/ask spreads, it would appear investors are overpaying for liquidity provision in some instances. Thus, for tick constrained issuers, it is reasonable to expect the proposed changes will tighten bid/ask spreads all else equal.

For non-interlisted issuers, particularly issuers with less liquid securities, Canadian regulators should investigate widening the minimum pricing and trading increments to encourage a more intelligent tick size.

(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).

If regulators can't harmonize the data set for interlisted issuers, Canadian regulators should apply the SEC data over the Canadian data.

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?

Yes. We would expect brokers to point their order routers towards marketplaces with the superior NBBO, after adjusting for FX cost and maker/taker fees. For Canadian interlisted issuers, roughly 57% of the shares already trade on US venues. If Canada doesn't match the proposed changes, we'd expect that share to increase.

(b) Does the difference in value between the Canadian and the American dollars matter in your analysis?

We presume there is a tight interlisted arbitrage between the value of an issuers shares in Canadian dollars and the value of an issuers shares in USD on average most of the time. If the minimum pricing increment was out of synch across Canada and the US then this arbitrage mechanism would become less efficient and we would expect the volume of the interlisted arbitrage activity to increase.

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.

The above technology concerns seem solvable to us. For example, many stocks in the UK already trade at fractions of a pence.

We would expect technology costs to increase as a result of the proposed changes (fixed costs related to hardware and variable costs related to throughput and market data).

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,

If the updates are both infrequent and predictable any associated disruptions should be manageable. An interesting parallel might be to follow a similar communication process to what the major index providers use to disseminate index constituent changes.

(b) the necessary lead-time between establishment and implementation of new minimum trading increments both initially and on an ongoing basis,

The formula used to calculate the minimum pricing and trading increments should be calibrated to deliver a stable output that is immune to small changes in observed parameters. Thus, after the first round of changes, we would expect future adjustments to existing securities to be rare.

(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)),

Brokers may need to cancel outstanding GTC orders and ask clients to reprice and replace them based on new bid/asks/midpoint increments. These adjustments, conceptually, would be similar to adjusting for a stock split or ex-dividend date or any other corporate action event that would impact the price of the shares and should be manageable even if it is tedious to implement.

(d) investor education challenges associated with an amended approach to minimum pricing increments.

Again, this problem seems solvable. OMS, EMS, algo gui and other platforms capturing order entry ought to be able to restrict the pricing increments and align with any changes.

Question 5: As modifying trading increments in Canada would impact the determination of a "better price"⁹ 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.¹⁰

UMIR defines a better price as 1 trading increment lower/higher than the best bid/offer. We do not suggest regulators change this definition simply because the value of 1 trading increment is changing and may vary across securities.

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.

Overall, we would expect the proposed changes to reduce bid/ask spreads, reduce displayed order size, reduce the average trade size, increase the quote replenishment rate, increase the tick-to-tick volatility and increase overall message traffic.

Smaller orders that should compete at-the-touch within a single marketplace on a single order book should benefit from tighter bid/ask spreads.

The impact on larger orders is more difficult to anticipate. The benefits of tighter bid/ask spreads could be overwhelmed by other negative externalities. See below:

- Tighter bid/ask spreads may be offset by lower quoted size (less risk premium associated with providing liquidity)
- Slower traders may observe less ability to quote and trade passively on the near side of the quote due to increased message traffic and inferior technology
- more quoting and trading in smaller, but recurring size makes it easier to detect patterns and infer the direction of a large parent orders, potentially raising trading costs for some traders

We would suggest monitoring the following metrics over time as well comparing averages pre/post any changes.

- Fill rates
- Cancellation rates
- Time-to-fill
- Time-to-cancel
- Average displayed order size at NBBO
- Average displayed market depth x levels deep
- Order queue depletion rate at the NBBO
- Various intervals of short-term volatility
- Magnitude of short-term serial correlation per security i.e. trending
- Degree of marketplace fragmentation, # marketplaces, # order books
- Ratio of displayed share trading vs non-displayed share trading
- Distribution of outcomes by participant type/client type– who benefited the most/least?

Question 7: Please discuss whether fee caps should also apply to “taker-maker” fee models and, if so, whether their fee caps should be different.

Yes. The fee cap should apply to both maker/taker and taker/maker fee models.

Question 8: Generally, the exact fee or rebate for an order cannot be determined until after an execution occurs, as discounted fees or credits are determined by marketplaces at the end of the month, based on trading during the month of a Participant. To be able to calculate the full cost of a transaction at the time of execution, the SEC also proposes to require that all exchange fees and rebates be determinable at the time of execution. U.S. trading venues would be required to set such volume thresholds or tiers using volume achieved during a stated period prior to the assessment of the fee or rebate so that market participants are able to determine what fee or rebate level would be applicable to any submitted order at the time of execution.

Please discuss whether we should take a similar approach in Canada.

Yes. Brokers have a potential conflict of interest and may route orders to a marketplace simply to qualify for beneficial fees/rebates. Such conflicts should be avoided.

Question 9: If adopted as proposed by the SEC, please provide your views on a Canadian approach to fee caps, including with respect to: (a) harmonization with an amended SEC rule, including with respect to application to inter-listed and/or non-inter-listed securities, (b) methodology used, including with respect to:

- i. application to all securities, regardless of price,
- ii. consideration of a fee cap that reflects tick size, similar to the methodology proposed by the SEC, and
- iii. consideration of a percentage-based fee cap for securities priced under CAD1.00.

Harmonization with the SEC is best. For non-interlisted securities there is some room for Canadian regulators to experiment with a more intelligent tick size, but caution is warranted here. Any changes, even perceived changes, in secondary market liquidity may encourage issuers to pursue US listings over Canadian listings.

Enhance Transparency about Better Priced Orders Available in the Market

On December 9, 2020, the SEC adopted the MDI Rules, but has not set an effective date for them. These rules expanded the content of core market data that will be made available for dissemination in the NMS and adopted a new decentralized model for its consolidation, collection, and dissemination. The MDI Rules amendments relevant to the SEC Proposed Amendments discussed in this notice are with respect to the Regulation NMS Amendments regarding the inclusion of a definition for “round lots,” as opposed to relying on exchange rules, and to require odd-lot order details be made available on market data feeds. In the U.S., information on NMS stock quotations is provided in round lots, which, until the round lot definition adopted pursuant to the MDI Rules is implemented, continues to be defined in exchange rules, which for most NMS stocks is 100 shares. To increase transparency about the best priced quotations available in the market, the U.S. MDI Rules specifically prescribe the following round lot size based on its share price: (i) for NMS stocks priced \$250.00 or less per share, a round lot will be 100 shares; (ii) for NMS stocks priced \$250.01 to \$1,000.00 per share, a round lot will be 40 shares; (iii) for NMS stocks priced \$1,000.01 to \$10,000.00 per share, a round lot will be 10 shares; and (iv) for NMS stocks priced \$10,000.01 or more per share, a round lot will be 1 share. For Canadian equity (or similar) securities, CISO’s UMIR defines “standard trading unit” to mean: (i) 1,000 units of a security trading at less than \$0.10 per unit, (ii) 500 units of a security trading at \$0.10 or more per unit and less than \$1.00 per unit, and (iii) 100 units of a security trading at \$1.00 or more per unit. In Canada, any order with volume less than a standard trading unit is considered an odd lot order. Odd lot orders are not currently considered in the national best bid and offer as they are considered “special terms orders” that do not trade in regular order books. Despite this, information about odd lot orders is readily available in marketplace data feeds. Our preliminary view is that enhancing the transparency of better priced orders does not need to be addressed in Canada. The transparency of order and trade data is sufficient in Canada due to the availability of odd lot data and the lack of off-exchange trading.

Question 10: Please discuss if you share our assessment and provide any additional considerations in this area.

The special terms status of odd lot orders is antiquated. Many institutional traders use odd lots to reduce tracking error when targeting a volume weighted average price benchmark. In the US, the sheer count of odd lot trades necessitates their inclusion in the NBBO and consolidated tape. Perhaps more investigation into odd lot trading in Canada is also warranted.

Regulation Best Execution

NI 23-101 and CISO's Investment Dealer and Partially Consolidated (IDPC) Rules¹² define "best execution" as obtaining the most advantageous execution terms for a client order reasonably available under the circumstances. Dealers are required to have appropriate policies and procedures and make reasonable efforts to achieve best execution. Factors to consider include price, overall cost of the transaction, liquidity, and speed and certainty of execution. Dealers should regularly review their best execution policies and procedures, and at least annually according to CISO IDPC Rules.¹³ With respect to the provision of the SEC Proposed Amendment relating to best execution to address potentially conflicted transactions in connection to PFOF, we note that UMIR 7.5 has the effect of prohibiting PFOF by a dealer. Our preliminary view is that the SEC Proposed Amendments in connection to Regulation Best Execution are not dissimilar to the existing best execution requirements in Canada and therefore, should likely have no implications for the Canadian best execution regime and no impact on Canadian capital markets.

Question 11: Please discuss if you share our assessment and provide any additional considerations in this area.

We agree.

Disclosure of Order Execution Information

Currently, the Canadian securities regulatory framework does not include requirements for disclosure by dealers and marketplaces of information related to order execution quality. In 2007¹⁴ and 2008¹⁵ the CSA published for public comment certain amendments to the relevant national instruments that would have introduced such disclosure requirements. In particular, marketplaces would have been required to publish monthly reports on liquidity, trading statistics and speed and certainty of execution, similar to SEC Rule 605. Dealers would have been required to publish quarterly reports on routing of orders when acting as agent, including information as to which marketplaces orders were being routed to for execution, and specifying the percentage of those orders routed at the direction of the client as opposed to the dealer's discretion, similar to SEC Rule 606. Since the public comments received in response to these proposals were mixed and did not communicate a clear stakeholder position, a decision was made at that time to not proceed with the proposals, but rather to continue to monitor developments in other jurisdictions regarding best order execution reporting requirements, and to monitor the impact of the evolving multiple marketplace environment. Our preliminary view is that, since we do not have equivalent disclosure requirements as SEC Rule 605, the SEC Proposed Amendments with respect to disclosure of order execution information should not affect Canadian markets.

Question 12: Please discuss if you share our assessment and provide any additional considerations in this area.

While it is not a consensus view across all members of the TIC committee, some of our members believe the CSA should explore this topic in further detail. Many of the same metrics applicable to question 6

would also be of interest to clients when analyzing and comparing their brokers' order handling. Thus, it may be an opportune time to revisit some form of standardized disclosure.

With regards to dealer level reporting for institutional clients in Canada, while there are providers that amalgamate dealer fill/routing data and provide reporting to institutional clients, access to these services is often very costly and the dealer data may not be comparable since there is no standardized definitions. In July 2016, the SEC proposed amendments to Rule 606 of Reg NMS that would *"require broker-dealers to provide enhanced disclosure of information regarding the handling of their customers' orders. Rule 606, as amended, requires more meaningful disclosures relevant to today's marketplace that encourage broker-dealers to provide more effective and competitive order handling and routing services and that also improve the ability of their customers to determine the quality of such broker-dealer services."* Since the proposed amendments to SEC Rule 606 were adopted in November 2018, standardized order handling disclosure is now more useful for institutional clients. Some TIC members believe that similar Canadian reporting should be mandated to promote transparency of institutional broker order handling practices and allow institutional clients to compare the execution quality and routing practices across dealers.

For retail clients, there is simply no source to compare execution quality across dealers in Canada, nor any transparency around routing practices, other than best execution disclosures that do not provide a high level of detail. The recently proposed changes to SEC Rule 605 are designed to further enhance the usability of the data to evaluate execution quality for retail client orders. The stated intention by the SEC to make the execution quality statistics more useful to market participants and to increase competition among dealers. Some of the TIC members believe that similar Canadian reporting should be mandated to present simple and meaningful information to retail investors, investment advisors and the financial press, to promote transparency of retail routing practices, and to foster competition between retail brokerage firms by allowing users to compare key statistics based on standardized calculation methods.

Order Competition Rule

Under National Instrument 21-101 Marketplace Operation, an "exchange-traded security" is a security listed on a recognized exchange. Correspondingly, CIRO's UMIR 6.4(1) prohibits any marketplace participant from trading in or participating in a trade in listed securities by means other than entry of an order on a marketplace unless an exemption is available. Additionally, Companion Policy 21-101CP Marketplace Operation clarifies that two characteristics of a marketplace are that it brings together orders for securities of multiple buyers and sellers and that it uses established, non-discretionary methods under which the orders interact with each other. Our preliminary view is that the issues addressed by the SEC Proposed Amendment concerning order competition do not exist in Canada. In Canada, orders are generally not permitted to be executed internally by a trading venue or dealer that restricts order by-order competition.

Question 13: Please discuss if you share our assessment and provide any additional considerations in this area.

We disagree. Perhaps it is worthwhile re-examining the use of broker preferencing and in particular the frequency and duration of orders involved in unintentional crosses within the same participant.

The CSTA TIC believes we all have a collective interest to protect and preserve a Canadian equity market that is fair and efficient for everyone. Despite living beside and competing with the largest, deepest, and most liquid capital market in the world, the Canadian capital market continues to thrive. Much of this success is due to our balanced approach to regulation and an engaged community of industry advocates. We applaud the CSA for proactively reaching out on this issue and would be happy to continue the discussion.

We thank you for the opportunity to comment.