ITG Canada Corp.
The Exchange Tower
130 King Street West, Suite 1040
Toronto, ON M5X 1B1 Canada
T 416.874.0900
F 416.874.0690
www.itg.com

October 24th, 2016

Market Regulation Branch
Ontario Securities Commission
20 Queen Street West 22nd Floor
Toronto, Ontario M5H 3S8
marketregulation@osc.gov.on.ca

Dear Sirs/Mesdames:

ITG would like to thank the Ontario Securities Commission for this opportunity to comment on the application of the proposed changes to the CSE Market Maker Participation.

ITG has been a long standing participant in the Canadian equity markets, and a strong proponent of innovation and healthy competition. At the same time we believe that markets should strive to offer equal, and fair access to all, as well as aim to reduce, not increase levels of intermediation.

The proposed CSE participation is yet more step down the path of marketplace segmentation. Unlike participation rights offered by both the TSX and Aequitas, the CSE models provides the market maker with the ability to participate only with Guaranteed Minimum Fill (GMF) eligible orders. These orders are almost exclusively retail, and due to their lack of size and order entry speed lack the information toxicity of larger, faster institutional orders. As such, they are the most profitable orders against which market makers would interact.

By facilitating a mechanism that allows market makers to trade in size, versus the most profitable counter parties, without requiring them to expose their orders to the market at large, the market makers will be able to quote in greater size for retail orders, and thus capture a larger share of such trading. This will result in greater profits for these market makers, at the expense of natural investors trying to build or unwind investment positions in the market. CSE makes this point themselves, in the proposal, when they openly state the proposal will “reduce the risk of adverse selection” for the market makers.

To illustrate this more clearly, let us imagine a casino poker room where a small, select set of preferred clients – as chosen by the casino – are able to chose which players sit at their table. They will certainly pick those with the least experience, in an effort to increase their expected value per hand, and per time period played. As those players are removed from other tables, the expected value of all other players in the room will drop. As expected value drops, any player with a reasonable understanding of risk management, will put fewer dollars at risk on any given hand, or orbit of the table. Instead of risking $1000, they may buy-in for $500. Allowing a subset of players to skim the “easiest money” impacts all other players, and their willingness to engage in the game.

This dynamic is true within the market as well. As the least informed active flow is vacuumed up using the market maker participation facility, the short term expected value of any remaining investor in the market will decline. Consequently, any trader or algo that appreciates adverse selection risk will reduce the size posted on the visible market, at any time, to reduce the risk of negative trades. This will result in less available liquidity at the NBBO, and a widening out of the spread, or worse, both.

The clear winners in this scenario are the market makers, who have been granted a low risk mechanism to trade with their preferred counter party, and the market facilitating this activity. The losers are the market participants who openly quote for trades, at the risk of trading with any counter party, and are less able to transact with retail flow. We have yet to see any evidence to suggest that any long term investors, be they retail or institutional, will benefit from this program. We are very confident that institutional flows will in fact be harmed. As such, we question the purpose for the proposal.

While the CSE states the proposal is partially driven by a need to “remain competitive with the offerings of other market places”, we believe they are in fact taking segmentation one significant step further than existing marketplace facilities. Given our strong belief that some of the existing facilities within our market offer too great a level of segmentation, we are clearly not in favour of taking things further still. We believe the CSA needs to define the goal posts of segmentation once and for all. We would strongly support an industry wide round table on this subject, to gather important data and views that might best inform the appropriate end point.

Thank you for allowing us the opportunity to comment on this proposal. As always, we would be more than happy to answer any questions, or expand upon our thoughts as desired.

Sincerely,

Doug Clark
Managing Director,
ITG Canada