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BY ELECTRONIC MAIL

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Dear Sirs and Mesdames:

RE: CSA REQUEST FOR FEEDBACK ON DECEMBER 2022 SEC MARKET STRUCTURE PROPOSALS AND POTENTIAL IMPACT ON CANADIAN CAPITAL MARKETS

The Investment Industry Association of Canada (the "IIAC") is the national association representing investment firms that provide products and services to retail and institutional investors in Canada.¹

We are writing in response to the October 19, 2023, *CSA/CIRO Staff Notice 23-331 – Request for Feedback on December 2022 SEC Market Structure Proposals and Potential Impact on Canadian Capital Markets*. The IIAC appreciates the opportunity to comment on the potential impact on Canadian markets resulting from the possible implementation of amendments to rules governing the US market structure.

¹ For more information visit, <https://iiac-accvm.ca/>

General Observations:

The proposed amendments to the SEC market structure present a complex scenario for evaluation, particularly concerning their impact on Canadian capital markets. We provide the following general observations:

i) Cost-Benefit Analysis

Although the potential benefits of these changes—in terms of enhanced market efficiency, increased transparency, and reduced transaction costs—remain unknown and may prove to be minimal, there is a definitive and considerable concern regarding the substantial cost they impose. Specifically, if adopted, Canadian market participants could likely encounter significant expenses related to adapting their infrastructural systems to comply with the new regulatory framework. This aspect underscores the necessity for a thorough and careful assessment of the proposed amendments, weighing the probable advantages against the definite and substantial costs of regulatory adaptation. Unfortunately, the time allocated for this staff notice falls short of providing the industry adequate time to conduct a thorough cost-benefit analysis of the SEC's market structure proposal.

ii) Interlisted and Non-interlisted

In considering the potential alignment of Canadian and U.S. market structures, it is crucial to differentiate between interlisted and non-interlisted stocks in the Canadian market. For interlisted stocks, alignment with the U.S. markets in aspects such as tick size, fee caps, and sub-penny listings seems inevitable. Conversely, maintaining the current structure may be more beneficial for non-interlisted Canadian stocks.

iii) Timing

Should the proposed amendments to U.S. market rules be enacted by April 2024, and if Canada seeks some level of harmonization with these changes, it is anticipated, absent further changes to US proposals, that there would be an implementation delay measured in years.

The SEC's proposed implementation timeline, from the proposal in December 2022 to implementation in April 2024, is notably short for such significant market structure modifications. This rapid pace might suggest a readiness of the U.S. markets to integrate these changes, potentially securing advantages within their market at the expense of other market participants. Conversely, it appears highly improbable that the Canadian market could adapt at a similar speed.

We provide the following in response to questions raised by the CSA:

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:

1. 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,

2. 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),
3. 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).

IIAC Response:

- Canadian regulators should not adopt the changes proposed by the SEC for Canadian-listed securities. Only interlisted securities should be considered for harmonization after a thorough study is conducted to see their benefit. The study should also consider the differences between liquid and illiquid interlisted securities.
- Our members disagree that we should change the UMIR rules to allow sub-penny pricing. This is of particular concern for equities that are listed on the TSX Venture Exchange where liquidity is low, and with the introduction of sub-penny pricing (beyond the allowed half-penny for securities less than CAD 0.50) would further reduce liquidity in this market.

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

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

IIAC Response:

- If not amended to align with the SEC proposal, we believe there would be less order flow to Canadian marketplaces, particularly from institutional investors. Canadian retail orders may remain in Canada due to the FX spread being a factor. However, best execution obligations may still result in incremental order flow being directed to U.S. venues.

Question 3: Concerns have been raised in relation to:

1. 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
2. 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.

IIAC Response:

- Canadian order traffic has significantly increased during the pandemic, and any changes leading to further increase in message traffic from increased pricing increments will worsen it. There are

serious concerns about the Canadian market infrastructure's resiliency and system readiness if this proposal goes through.

- While the proposed pricing increments in the U.S. may lead to a more competitive market for their markets, Canadian regulators should look at alternative models for pricing increments that are more innovative.
- Here are some considerations for the Canadian regulators:
 - **Inter-listed Stock Example:** About 180 stocks have varying tick sizes across CAD and USD, highlighting an outdated system.
 - **Board Lots Relevance:** The traditional concept of board lots seems obsolete with current trading practices, as institutions increasingly trade odd lots.
 - **Technical and Infrastructure Demands:** Increasing quote volumes pose challenges, especially with outdated Information Processor systems, leading to market inefficiencies like crossed markets.
 - **Access Fees and Stock Prices:** Suggestion to incorporate access fees into stock prices, benefiting the beneficial owner and reducing broker conflicts of interest.
 - **Publishing Odd-Lot Information:** Advocating for the publication of odd-lot information alongside the consolidated bid and offer (CBBO) for board lots for greater market transparency.

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:

1. complexities associated with the frequency at which minimum trading increments could change,
2. the necessary lead-time between establishment and implementation of new minimum trading increments both initially and on an ongoing basis,
3. 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)),
4. investor education challenges associated with an amended approach to minimum pricing increments.

IIAC Response:

- Adopting a similar rule in Canada could affect a significant portion of securities, potentially leading to smaller trading increments and impacting a considerable volume, value, and number of trades.
- While minimum price increments in the U.S. only apply to transactions occurring on the marketplaces, creating a regulatory arbitrage to attain better prices off-exchange than on-exchange, no such conflict exists in Canada to make adjusting tick size a policy imperative.
- Exchange Traded Funds (ETF) is an area which may require special consideration since quoted prices of ETFs are derived from other instruments. Reducing tick sizes on ETFs would likely increase message traffic without improving liquidity.
- An alignment with the US market might look good for clients, but it will come with additional costs that will ultimately be passed back to the client. Additional messages are not free by the vendors, and some degree of cost recovery is inevitable, potentially nullifying any advantage to clients.

- Any consideration for implementing the SEC proposed changes in Canada should be aligned with the U.S. but preferably staggered in implementation.
- Some changes may be required over time if the U.S. adopts the proposed policy as final, but this could potentially be delayed until after an assessment period.

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.

IIAC Response:

“Best Price” at sub-penny is almost immaterial. However, it may adversely affect trade flows since costs will begin to matter more and will become consequential. In addition, if trades occur at sub-penny increments, then displays must also show trades at sub-penny levels; otherwise, the trades are occurring out of view. This does not build trust in a system that is supposed to be transparent.

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.

IIAC Response:

A voluntarily imposed fee cap seems counterproductive. The question remains as to why give away the flexibility to determine fees based on market attributes and follow the proposed U.S. system instead, especially if the difference in fees remains minimal. While ultimately, this is unlikely to harm trading in Canadian interlisted securities as some degree of alignment will take place gradually, it is unlikely that this will help Canadian markets become more competitive and efficient if this rule change were to be imposed. This will likely reduce liquidity and have a negative impact on overall execution quality if market makers cannot pick up the penny spread with a rebate for posting. It is essentially the equivalent of placing rent controls on capital markets and will likely have negative consequences.

Question 9: If adopted as proposed by the SEC, please provide your views on a Canadian approach to fee caps, including with respect to:

1. harmonization with an amended SEC rule, including with respect to application to inter-listed and/or non-inter-listed securities,
2. methodology used, including with respect to:
 1. application to all securities, regardless of price,
 2. consideration of a fee cap that reflects tick size, similar to the methodology proposed by the SEC, and
 3. consideration of a percentage-based fee cap for securities priced under CAD1.00.

IIAC Response:

Not seen as having a meaningful impact either way. Please see the response to question 7.

Question 10: Please discuss if you share our assessment and provide any additional considerations in this area. (Odd lot orders)

IIAC Response:

Odd-lot trading is becoming more prevalent, and clients just as easily ask for ‘\$20 worth of shares’, as they would to buy 100 shares. Information is available, and trades are already well accommodated.

As odd lot orders in Canada are required to be executed on marketplaces, and since the odd lot book is consumed by most trading systems allowing for passive execution of the order, there is no immediate need for a policy response.

Question 11: Please discuss if you share our assessment and provide any additional considerations in this area. (Regulation Best Execution)

IIAC Response:

No need for further alignment with the U.S. market on this. Canadian trades generally should not go through U.S. exchanges if interlisted, as orders will occur at three points – outgoing, FX, and return order, potentially generating a suboptimal spread.

As it stands, there are no significant and impactful dissimilarities between the SEC proposal on Best Execution and existing best execution requirements in Canada.

Question 12: Please discuss if you share our assessment and provide any additional considerations in this area. (Disclosure of Order Execution Information)

IIAC Response:

Canadian market structure, especially the requirement that all trades occur on a marketplace, does not give rise to the same issues that the SEC seeks to address with disclosure rules. In fact, mandating frequent reporting on the routing of orders when acting as an agent could impose undue regulatory burden on broker-dealers, and unlikely to materially inform broker selection if that is the intent.

Question 13: Please discuss if you share our assessment and provide any additional considerations in this area. (Order Competition Rule)

IIAC Response:

Generally, a non-issue in Canada – UMIR 6.4(1) already places sufficient restrictions on orders not on a marketplace.

Thank you for the opportunity to share our insights.

Sincerely,

Sam Uddin
Managing Director

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Director