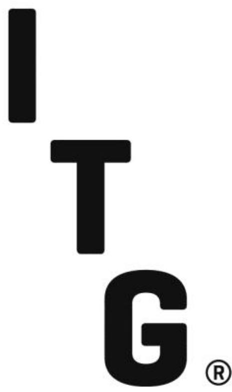

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ITG Canada (ITG) would like to thank the IIROC for the opportunity to comment on the proposed anti avoidance rules. We strongly believe the Canadian regulatory comment process makes for a stronger and more credible marketplace.

When considering complex market structure, or microstructure proposals, ITG believes that it is important to tether our thoughts to the essential properties that establish fair and efficient markets. To that point, we borrow heavily from historical pieces published by the SEC and CSA, and suggest that fair and efficient markets should aspire to the following 5 goals.

1) Efficiency – Markets should create the means for the most economical and efficient execution of securities transactions

2) Fairness – Markets should allow for fair competition among brokers and also among trading venues

3) Transparency – Markets should be transparent in their operations, and offerings

4) Practicality – Markets should ensure that adherence to rules is logistically practical and reasonable

5) Intermediation – It should be the goal of all markets to limit, not grow, the rate of marketplace intermediation.

With these goals in mind, we focus our lens on the proposed anti avoidance regulations.

Efficiency:
Under the proposed regulation, Canadian broker dealers would now be required to sometimes forgo better priced liquidity in the United States, and avoid trading in some of the most cost efficient venues, factoring in both implicit and explicit costs. Regulation that forces clients to accept worse prices, and dealers to trade for clients exclusively on more expensive trading venues, seems to be anathema to efficiency. Forcing Canadian dealers to trade on more expensive lit venues also removes the vital incentive for existing markets to more competitively price their product.

Fairness:
The proposal also introduces a fundamental lack of fairness to Canadian investors. . If enacted as proposed, anti-avoidance would put Canadian dealers at a significant disadvantage to U.S. based dealers when trading the same stock; ironically which is typically a Canadian-based company. A non Canadian client (from the US or Europe or Asia) would be acting against their own self interest in sending small interlisted trades to a Canadian trading desk that is subject to anti avoidance, as opposed to routing to a U.S. based desk, that has similar access to both markets without the handicap having to avoid significant U.S. dark liquidity. To the extent that many large clients route their small and large orders in a similar manner, the Canadian dealer community would be severely disadvantaged in their ability to win trade flow as a result of this rule. Further, by restricting the abilities of Canadian dealers, these non Canadians would be less apt to send baskets of orders with some interlisted names, and thus further damage the abilities of Canadian Dealers. It is sadly ironic, and concerning that Canadian regulators, in an attempt to protect the robustness of the Canadian

Capital Markets, have proposed a rule that will severely impede the ability of Canadian dealers from competing for such flows.

The rules will also place small Canadian asset managers at a disadvantage to U.S. asset managers when investing in interlisted securities. Such small managers will be forced, via anti avoidance rules, to bypass cheaper liquidity that would be available to their U.S. peers, which ultimately will manifest itself in reduced rates of return. The performance of the Canadian investor could be harmed by this proposal.

Furthermore, we note that issuers listed in both markets will unfairly bear the burden of increased investor costs. A Canadian investor seeking exposure to auto manufacturing might decide to invest in Ford rather than General Motors (GM), simply to avoid the complexity and cost of trading in interlisted names like GM. This could have the negative unintended consequence of reducing both the investor base and valuation of GM.. We have already seen Lulemon, a Canadian startup, delist from the TMX; more could follow. This lack of fairness is likely to result in the executives of interlisted firms reconsidering the Canadian listing. It is not a great stretch to suggest that companies, like GM, or Blackberry, where the investor base and liquidity increasingly resides in the U.S., will seriously consider delisting from the TSX. And new IPOs, from both foreign and Canadian based companies, will be attracted to the increasingly relative size of US investment, and ease of trading. The impact to overall Canadian Capital Markets could be devastating.

Practicality:
The proposal appears to be further flawed since small Canadian dealers would be challenged to find U.S. dealers that are willing to route flows in a manner that is counter intuitive to their own FINRA best execution obligations. Beyond this, small dealers that use third party trading technologies will have challenges connecting algorithms from one provider with smart order routers (SOR) from another provider in a manner that allows the SOR to trade against U.S. dark flows when allowable. This will have the unfortunate impact of forced bundling of services, which would seem to be counter to the desires of most regulatory bodies.

Intermediation:
Finally, in terms of reducing intermediation the proposal once again appears to be wanting. According to the most recent paper published as part of IIROC's Study of High Frequency Trading – "*The Impact of the Dark Trading Rules*"[1] – the dark rules enacted in October 2012 resulted in improved ability by High Frequency Trading firms to capture flow on the passive side of the quote, forcing all other participants to cross the spread more often, and trade on more expensive venues, without any offsetting "market-wide changes in price efficiency". Anti avoidance will almost certainly exaggerate this effect, and create even greater opportunity for high frequency trading strategies to profit from the inefficient routing practices forced upon Canadian dealers, resulting in greater intra market intermediation.

When viewed through the lens of creating fair and efficient markets, we find the proposal fails to meet all but one of the stated goals.. As such, ITG must strongly recommend against proceeding with this proposal. This leaves the question of what we should do to protect the robustness of the Canadian Capital Markets.

First and foremost, we must understand and quantify the problem that we are trying to solve. We need to understand both the existing rate of flow being sent south, along with the volume of flow that could potentially be sent south. Once regulators have a better grasp of the potential harm to markets, should the markets be unable to find an effective manner to compete fairly, then the regulators need to determine the volume and value of interlisted flow sent into Canada. Without meaningful data and proper analytics, regulators will be challenged to properly assess what would be a net benefit to Canadian Capital Markets.. ITG strongly believes that, after collecting the data and doing the math, Regulators will realize that Canada has far more to lose than gain from this proposal..

Consequently, Canada needs to come together and, putting aside competing business models and economic interests,honestly consider various practical market solutions to combat this potential problem. We need to provide proper incentives for the flow to stay in Canada, without building walls which might prevent orders being routed to Canada from other jurisdictions. This debate needs to be open to all possible solutions, including a repeal of the dark rules.

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[1] March 6, 2015 – "The Impact of the Dark Trading Rules" – co-authored by Andreas Park, Katya Malinova and Carole Comerton-Forde

We do believe that improved transparency around the both the historic and current flows being sent to U.S. markets will be insightful and sobering.

In conclusion, while the added complexity presented by anti avoidance rules are almost certainly favourable to ITG, we cannot in good conscience support rules that will put the Canadian asset managers and dealers at an unfair disadvantage to our peers in the U.S., trading Canadian securities.. We appreciate the opportunity to share our views on the important market structure issue, and offer our continued guidance going forward.

Sincerely,

Doug Clark
Managing Director,
ITG Canada