CANADIAN SECURITY TRADERS ASSOCIATION, INC.
P.O. Box 3, 31 Adelaide Street East
Toronto, Ontario M5C 2H8

April 10, 2017

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

and

Mark Faulkner
Vice President, Listings and Regulation
CNSX Markets Inc.
220 Bay Street, 9th Floor
Toronto, ON M5J 2W4
mark.faulkner@thecse.com

Re: Canadian Securities Exchange Public Interest Rule Amendment: Rule 4-113 ("the Proposal")

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 volunteer Governors from each of three distinct regions (Toronto, Montreal 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 the CSTA Trading Issues Committee (the "Committee", "CSTA TIC" or "we"), a group of 22 appointed members from amongst the CSTA. This committee has an equal proportion of buy-side and sell-side 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 Committee was assigned the responsibility of presenting the views of the CSTA as a whole. The views and statements provided below do not necessarily reflect those of all CSTA members or of all members of the Trading Issues Committee.

The Canadian Security Traders Association appreciates the opportunity to comment on the proposal by the Canadian Securities Exchange (the "CSE") to amend the Guaranteed Minimum Fill ("GMF") facility, allowing GMF-eligible orders to be filled at the National Best Bid or Offer ("NBBO") (the "Proposal"). As we will discuss below, we believe that the Proposal should be denied because we believe it will decrease the quality and reliability of price discovery in the Canadian equity markets. By allowing a marketplace the ability to fill orders without displaying a quote on in its own book does a disservice to overall market quality, with an important impact to those participants that are willing to contribute to actively enhance price discovery by posting visible quotes.

We highlight that a previous proposal from the CSE, to introduce a GMF Participation feature with analogous ability to fill active GMF-eligible orders at the NBBO, was approved in an amended form which removed the ability for the market maker to use the Participation feature to interact with GMF-eligible flow at the NBBO. We agree that this amendment was entirely appropriate. We believe that the current Proposal is substantially similar in nature to the CSE GMF Participation Proposal, in that it contemplates the CSE's designated market maker interacting with GMF-eligible flow at the NBBO, without regard for the CSE's own quoted prices. As such, we believe the substantive amendments to the CSE GMF Participation Proposal should serve as a precedent to the current Proposal, and similar regulatory treatment should apply.

Retail Interaction Facility

In the CSE's rule book, orders which are deemed GMF-eligible are those which are not part of a larger orders, not directed by a DEA client (unless the DEA client is executing retail flow), not entered on behalf of a US dealers and not for a client that is generally involved in trading on a daily basis. For all intents and purposes, we believe that the definition of GMF eligibility is designed to describe small retail investor flow to the exclusion of typical institutional-sized orders and order flow from professional market participants. In our discussion below, we will not differentiate the term small retail-sized orders with retail orders.

Contribution to Price Discovery

Historically, guaranteed fill facilities such as the TSX MGF and CSE GMF were designed with the intent of offering a last-resort alternative for retail clients with small orders to be filled without undue market impact. The original design of the TSX MGF, which persist to this day, would have the TSX's Registered Trader ("RT") fill the unfilled portion of a marketable order at the TSX best bid or offer after all available visible liquidity is exhausted and only up to a pre-determined size. In other words, the RT was buyer or seller of last resort and with a maximum exposure of the pre-determined MGF size.

By placing the RT's obligations as a last resort, the mechanism encouraged price discovery in the lit market by giving resting orders an opportunity for a first fill on the TSX, prior to the RT being able to interact with active flow.

We believe that the CSE's GMF proposal upends the trade-off between last resort liquidity available to retail order and price discovery by allowing the CSE's designated market maker ("MM") to interact with active flow, at the prevailing NBBO, without any requirement for the CSE to contribute to price discovery by displaying a quotation. On the contrary, under the Proposal, the CSE would be piggybacking on quotes established on away markets to allow the market maker to interact with active retail flow, thus taking away an opportunity for displayed orders elsewhere to be filled at their displayed prices.

This dynamic is further exacerbated by the CSE currently offering an inverted fee structure on GMF-eligible stocks. The inverted fee structure incents active flow to target the CSE, but creates a disincentive to rest limit orders due to the relatively higher cost of execution for resting orders. Under the Proposal, active retail flow would interact with the CSE GMF and specifically with the CSE's appointed market maker, regardless of whether the CSE displayed a quote, while at the same time discouraging participants from resting orders on the CSE book which would compete with the market maker for passive fills.

In practice, the Proposal would have the effect of creating a marketplace where active flow is filled by a specific market maker, without the requirement for the market maker (or anyone else on CSE) having to display a competitive quote with respect to the NBBO.

This model is analogous to a new marketplace which would permit fills at the NBBO without ever displaying quotations, with the further constraint that the only passive liquidity provider is the marketplace's chosen designated market maker. We believe that on a stand-alone basis, such a marketplace would be in violation of several fundamental rules in the Canadian market, and would not be permitted. Similarly, a model proposed by an existing exchange (such as the CSE) should also be seen as contrary to the Canadian market framework if it has the equivalent effect of providing passive fills to a chosen market maker at the NBBO without the requirement to displayed quotations,

Additionally, we note that the CSE response to comments for its prior proposal, asking for the GMF Participation feature to be applicable at the NBBO, contemplated that the feature would respond to marketable orders being directed to a marketplace in response to visible quotations, "contributing to price discovery and liquidity."[1] We note that under the Proposal currently at question, the CSE would no longer require a contribution to price discovery from market makers, and instead permit the designated market maker for a stock to interact with marketable flow with neither party contributing to price discovery in the market. We therefore believe the CSE's prior comments in response to CSTA concerns are inconsistent with the Proposal as presented.

Conclusions

We believe that the Proposal harms price discovery and overall market quality of the Canadian equity markets by attempting to position the CSE GMF facility as a mechanism for selected market makers to interact exclusively with retail flow without any price improvement. The damaging consequences of this type of facility is further enhanced by discouraging passive quotations through the inverted fee structure, circumventing the original intent of GMF facilities as a last resort source of liquidity. In the absence of quotations at the NBBO, this model will transform the CSE into a dedicated retail interaction market which is inaccessible to the broader institutional and professional community. We believe that disallowing access for all participants to provide passive quotes would be a violation of fair access requirements under National Instrument 21-101 Marketplace Operations given that there are no associated quotation obligations.

Based on the above, we strongly believe that the Proposal should be denied.

Thank you for your attention in this matter.

Respectfully,

[1] http://www.osc.gov.on.ca/en/Marketplaces_cnsx_20170216_market-maker.htm

"Signed by the CSTA Trading Issues Committee"

c.c. to:

Ontario Securities Commission:
Ms. Maureen Jensen, Chair & CEO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

Alberta Securities Commission:
Ms. Lynn Tsutsumi, Director, Market Regulation

Autorité des marchés financiers:
M[e] Élaine Lanouette, Directrice des bourses et des OAR

British Columbia Securities Commission:
Mr. Mark Wang, Director, Capital Markets Regulation

IIROC:
Mr. Andrew Kriegler, President and CEO
Ms. Victoria Pinnington, Senior Vice President, Market Regulation
Mr. Kevin McCoy, Vice-President, Market Regulation Policy
MS. Sonali GuptaBhaya, Director, Market Regulation Policy