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**Re: Provisions Respecting Dark Liquidity**

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FAIR Canada is pleased to offer comments on the proposed amendments to UMIR relating to dark liquidity as set out in IIROC Notice 11-0225 dated July 29, 2011. FAIR Canada also wishes to make some general comments on the positions taken by the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) in their joint staff notice 23-311 on “Regulatory Approach to Dark Liquidity in the Canadian Market” (the “Joint Notice”).

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

**FAIR Canada Comments – Executive Summary**

1. FAIR Canada supports the policy rationale for the regulatory approach being taken by the CSA and IIROC as described in the Joint Notice. We agree that the regulatory framework should allow the use of dark liquidity, but should manage its impact on price discovery, fairness and overall market quality.
2. FAIR Canada supports limiting the exemption from the pre-trade transparency requirements to orders that meet the “Dark Order Size Threshold.” We therefore support the UMIR amendment to permit IIROC to designate a minimum size for orders that are not displayed in a consolidated market display.
3. FAIR Canada supports the principle that a visible order entered on a marketplace that trades with a dark order should receive price improvement, unless the former order exceeds a certain size threshold. We support the related UMIR amendment.

4. FAIR Canada supports the principle that visible limit orders should execute before dark orders at the same price when they are on the same marketplace. We therefore support the proposed UMIR amendment that requires visible orders to receive priority of execution over dark orders in a given marketplace.
5. FAIR Canada supports the principle that visible orders should receive meaningful price improvement if executed against a dark order. We therefore support the proposed definition of a “better price” in the UMIR amendments.
6. FAIR Canada views continued monitoring of the impact of dark pool markets and dark liquidity on overall market quality and market integrity as the market evolves to be very important.

**1. FAIR Canada supports the policy rationale for the regulatory approach being taken by the CSA and IIROC as described in the Joint Notice.**

- 1.1. FAIR Canada agrees with the view expressed in the Joint Notice: The regulatory framework should allow the use of dark liquidity, but should manage its impact on price discovery, fairness and overall market quality. With the advent of multiple dark pools, various forms of dark orders and increasing fragmentation of trading services, FAIR Canada believes that rules are needed to ensure that minimum standards of fairness, transparency and market integrity are protected and promoted. Specifically, the rules should promote transparency in markets, encourage the posting of orders on markets’ visible order books, and protect markets’ visible pricing mechanisms.
- 1.2. FAIR Canada believes these principles are particularly important for individual investors, who may not understand dark pools, or be in a position to take advantage of them or other specialized trading services. Users of dark liquidity also should not be permitted to take unfair advantage of individual investors who must use visible markets (for smaller orders) and who continue to rely on visible markets for trade execution quality.
- 1.3. We acknowledge that certain orders, in particular larger orders, can benefit from use of dark pools and non-visible order forms due to the potential market impact of displaying an order. FAIR Canada believes that the regulatory approach adopted by the CSA and IIROC strikes a reasonable balance between the goals of 1) promoting transparency and overall quality in markets; and 2) promoting competition in trading services and use of alternative trading mechanisms to improve markets’ efficiency in handling certain kinds of orders.
- 1.4. FAIR Canada agrees that regulators should be proactive in establishing a regulatory framework that anticipates the potential impact of dark liquidity, rather than waiting and reacting after the fact. Although dark pools do not account for a large percentage of trading activity today, we believe that it is important to enunciate the regulatory principles that should apply to dark liquidity now. It will be more difficult to impose regulatory restrictions on its use later, if dark liquidity becomes a greater factor in the market.

2. **FAIR Canada supports limiting the exemption from the pre-trade transparency requirements to orders that meet the “Dark Order Size Threshold.”**
  - 2.1. FAIR Canada agrees with the CSA that transparency is a fundamental building block of a fair and efficient market, and that regulatory principles should therefore promote transparency, including the use of visible marketplaces.
  - 2.2. FAIR Canada also believes that limiting the exemption from order display requirements is consistent with the existing order exposure rule in UMIR, which ensures that small-sized orders are immediately entered on a visible marketplace. Not only do these requirements promote transparency, they also ensure that smaller orders – often orders from individual investors – obtain the benefits of being exposed to the open auction market for securities, and obtain the best available price.
  - 2.3. Although FAIR Canada supports “permitting” IIROC to designate a minimum size for dark orders that are not displayed in a consolidated market display, we believe it is essential that IIROC designate a minimum size when the rules on dark liquidity are introduced. FAIR Canada understands that the CSA and IIROC intend to work jointly on proposing a reasonable minimum size. We believe it is important for the CSA to ensure IIROC designates a minimum size in the near future, in conjunction with implementation of the overall regulatory regime for dark liquidity.
3. **FAIR Canada supports the principle that a visible order entered on a marketplace that trades with a dark order should receive price improvement, unless the former order exceeds a certain size threshold.**
  - 3.1. Requiring dark orders to provide price improvement encourages the entry of visible orders and ensures that smaller orders will receive an advantageous price – better than the best price in the quoted market – if executed against a dark order. We therefore support the proposed UMIR amendment that requires orders executed against a dark order to receive price improvement, unless the displayed order is a very large order (i.e. valued at over \$100,000 or more than 50 trading units in size).
4. **FAIR Canada supports the principle that visible limit orders should execute before dark orders at the same price when they are on the same marketplace.**
  - 4.1. Giving priority to visible orders encourages visible liquidity in marketplaces and is fundamental to the protection of the price discovery process. We believe that the visible pricing mechanism contributes to liquidity and efficiency of markets to a greater degree than invisible liquidity does, while acknowledging that some kinds of orders benefit from the use of dark liquidity. We therefore support the proposed UMIR amendment that requires visible orders to receive priority of execution over dark orders in a given marketplace.
5. **FAIR Canada supports the principle that visible orders should receive meaningful price improvement if executed against a dark order.**
  - 5.1. We therefore support the proposed UMIR amendment to define a “better price” as at least one trading increment (as defined in UMIR), unless the bid-ask spread for a security is the minimum one trading increment. In that case we agree that price improvement of

at least one-half of one trading increment is adequate.

- 5.2. If meaningful price improvement is not required, FAIR Canada believes that incentives to enter orders on visible markets could be undermined, because dark orders could be executed at essentially the same price as visible orders by providing only nominal price improvement. This approach could impair transparency in markets and the overall efficiency of markets' visible pricing mechanism. The risks related to exposing orders to the market could exceed the benefits if visible orders do not receive meaningful price improvement when executed against a dark order.
- 5.3. FAIR Canada supports application of the revised definition of a "better price" to the requirements under the Order Exposure Rule (Rule 6.3 which permits small orders to be withheld from an immediate entry on a marketplace if executed at a "better price") and the Client-Principal Trading Rule (Rule 8.1 which requires that principal trades with small client orders be undertaken at a "better price" in order to avoid conflicts). Both of those rules are important protections for small individual investors' orders. They ensure that dealers treat small orders fairly and that any conflicts of interest in handling small orders are mitigated.

## 6. Continued monitoring important.

- 6.1. Finally, as the regulators propose in the Joint Notice, FAIR Canada believes that it is important for the regulators to monitor the impact of dark pool markets and dark liquidity on overall market quality and market integrity as the market evolves. The regulators should be prepared to take action, and to implement additional rules, if monitoring demonstrates that market quality or integrity is being impaired. The regulators should determine the methodology that they will use to monitor and to assess the impact of dark liquidity in the near future. FAIR Canada suggests that periodic reports on the monitoring and assessment program should be prepared, and that the regulators make public a summary report on the results of their monitoring and assessment program at least annually.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282 / [ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights