

**RECOGNITION OF
AEQUITAS INNOVATIONS INC. AND AEQUITAS NEO EXCHANGE INC.
NOTICE OF APPROVAL**

On November 13, 2014, the Commission recognized each of Aequitas Innovations Inc. (Aequitas Innovations) and Aequitas Neo Exchange Inc. (Aequitas Neo Exchange) as an exchange. The recognition is effective as at March 1, 2015.

The Recognition Order sets out the terms and conditions of recognition and includes the review process to be followed for the rules, policies and other similar instruments of Aequitas Neo Exchange.

Pursuant to various terms and conditions of recognition, the Commission has also approved the following:

- The Rules of Aequitas Neo Exchange, these being the Trading Policies of Aequitas Neo Exchange (Trading Policies), the Member Agreement, the Designated Market Maker Agreement and the Listing Manual and Related Forms of Aequitas Neo Exchange;
- The ownership interest of Aequitas Innovations in Aequitas Neo Exchange, pursuant to section 3 of Schedule 2 of the Recognition Order;
- The ownership interest of Barclays Corporation Limited, CI Investments Inc., IGM Financial Inc., ITG Canada Corp., OMERS OCM Investments II Inc., PSP Public Markets Inc. and RBC Dominion Securities Inc. in Aequitas Innovations; and
- The regulation services to be performed by IIROC for Aequitas Neo Exchange, pursuant to subsection 10(b) of Schedule 2 of the Recognition Order.

1. Issues

The application for recognition (Application) was published on June 27, 2014 for a 60 day comment period. 60 comment letters were received. Along with the Application, we published a staff notice (June Notice), seeking comments on all aspects of the Application and on a number of specific issues. A summary of the comments and responses prepared by Aequitas Neo Exchange is attached at Appendix A of this notice. Staff have reviewed the summary of comments and responses prepared by Aequitas Neo Exchange to assess their adequacy and, where appropriate, we have added our comments. In this notice, staff specifically address the comments regarding the access to the Neo Book of Aequitas Neo Exchange and on the specific issues we raised in the June Notice.

a. *Access to the Neo Book*

In the June Notice, we noted our view that the different treatment of orders from Latency Sensitive Traders¹ (LSTs), which would be subject to speed bumps and higher fees on the Neo Book, did not unreasonably prohibit, condition or limit LSTs' access to the Neo Book. We requested comment on this matter. A number of commenters raised concerns that these features, and especially the imposition of speed bumps, would result in unequal and restricted access to the marketplace. Commenters also noted that, if this model is adopted by Aequitas Neo Exchange, it could lead to a proliferation of segmentation on visible markets, which could impact market quality by restricting interaction of market participants' order flow.

We have considered the comments received and note the concerns raised. We agree that Aequitas Neo Exchange would be the first transparent marketplace to introduce differentiated access standards to its facilities. This was a significant consideration in our review. We have assessed whether the trading model and access standards of Aequitas Neo Exchange comply with the fair access requirements articulated in National Instrument 21-101 *Marketplace Operation* (NI 21-101), which require that a marketplace not unreasonably prohibit, condition or limit access by a person or company to services offered by it. We are of the view that the model proposed is not inconsistent with these requirements. While the standards for access will not be the same for all participants, we believe some flexibility and differentiation is not unreasonable, as long as participants are not unreasonably prohibited or limited from accessing a marketplace. In our view, while the access to the Neo Book will be different for the LSTs, there is no unreasonable limit or barrier to access this book that would apply to any group of participants.

We recognize that this model may lead to other proposals that may differentiate between marketplace participants. We have always reviewed proposed changes to the Canadian market, including each new marketplace, or new or changes in trading structures and access requirements, by considering the impact of every change on the market. We will continue this process and will review each proposal considering its impact on the market and market participants and with a view to factors such as fairness, transparency, liquidity and market integrity.²

b. *Definition of LST*

¹ As defined in the Trading Policies published for comment with the Application.

² The characteristics of an ideal market underlying our regulatory objectives are set out in a number of publications, including CSA Notice and Request for Comment – *Proposed Amendments to National Instrument 23-101 Trading Rules* published on May 15, 2014 and available at http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20140515_23-101_rfc-pro-amd.htm. They are liquidity, immediacy, transparency, price discovery, fairness, market integrity and transaction costs.

A number of commenters noted that the definition of LST included in the draft Trading Policies published with the Application was too broad and could have included accounts that are not necessarily used for latency-sensitive trading strategies. Commenters also indicated that there was potential to circumvent the definition by market participants. Concerns were raised regarding the process to monitor whether market participants are adequately categorized as LST participants. In response to these comments, Aequitas Neo Exchange revised the LST definition. LSTs will now only include proprietary traders of dealers using automated, co-located trading strategies, and direct electronic access clients that use automated, co-located trading strategies. The new definition is included in the Trading Policies published with this notice. Staff are satisfied that this definition is appropriate and its application can be effectively monitored by Aequitas Neo Exchange.

c. Governance Requirements

The Recognition Order of Aequitas Neo Exchange and Aequitas Innovations is similar to recognition orders currently in place for other exchanges operating in Ontario. Staff note, however, that the terms and conditions in this Recognition Order, including those applicable to governance, are tailored to the operations of Aequitas Neo Exchange and to the functions and responsibilities of Aequitas Innovations. Some differences exist as a result of the significantly smaller size and scope of the operations of Aequitas Neo Exchange.

d. Other Changes

Subsequent to the publication of the Application, and further to public comments and additional staff comments received, Aequitas Neo Exchange made a number of non-material changes to the Trading Policies, Member Agreement, the Designated Market Maker Application Form and Agreement and Listing Manual (together, the Manuals).

The Manuals published with this notice and the Recognition Order reflect these changes.

e. Responses to Staff's Questions

In the June Notice, we requested comment on all aspects of the Application and on a number of specific issues. These issues, comments received and our responses are set out below.

(i) Benefits and obligations of market makers

We asked whether market makers should have obligations with respect to the Dark Book of Aequitas Neo Exchange and, generally, to a non-transparent marketplace.

Almost all commenters believed that market makers should not have obligations in a dark book. They noted that quoting obligations are designed to be visible and to benefit price discovery, which is in contrast with the whole concept of a dark book, where it is not known whether there is available liquidity. Further, imposing quoting obligations for venues in which quotes are

never disseminated does little to further the goals of market efficiency, price discovery, or preventing price dislocations, which are the objectives of the market making function.

Commenters also noted that imposing market maker obligations in a dark book could promote the increased execution of smaller sized orders in the dark, as dealers would be expected to direct their orders to dark markets in order to meet best execution obligations. This could negatively impact the effectiveness of the price formation and discovery process in the visible markets.

One commenter believed that there should be obligations for market makers in a dark book, but only in addition to the market makers' existing obligations to provide liquidity in the visible markets.

Staff agree with commenters that market makers should not have obligations in a non-transparent marketplace. This would effectively confirm to market participants that market makers are present and actively providing liquidity in the dark book. This, in turn, is inconsistent with the nature of a dark market, where no guarantee of liquidity is provided, as one of the trade-offs of trading "in the dark".

We also requested comment on whether it is appropriate to have benefits in the Dark Book but no obligations. Some of the commenters who expressed views on this issue were supportive of market makers receiving benefits in the Dark Book, despite the fact that they have no obligations. It was noted that offering benefits in the Dark Book of Aequis Neo Exchange for the satisfaction of obligations in the Lit and Neo Books was reasonable, as these benefits would service as further incentives to provide liquidity and improve market efficiency and quality of the market as a whole. That is, benefits received by market makers on all the books should be viewed as an overall package that will promote liquidity provision.

Some commenters, however, were not supportive. They indicated that the benefit of the trading priority in the Dark Book is not aligned with the obligation to provide a quote. One commenter believed that it was not appropriate for quoting obligations in one order book to translate to benefits in a different book.

Based on the concerns raised, it has been determined that it is not appropriate for benefits to be provided to Designated Market Makers in the Dark Book where no obligations exist. As a result, Aequis Neo Exchange has revised its Trading Policies to remove the benefits for market makers on this book. With respect to the overall market making program, staff intend to monitor the proportionality of the benefits and obligations of Designated Market Makers and have amended the recognition order to require reporting of statistics and analysis to assess this.

(ii) Market Makers' Commitment (MMC)

We requested specific feedback on whether the MMC, which would allow designated market makers to commit additional dark liquidity at multiple price levels and in varying quantities

within the Lit and Neo Books for securities listed on the Aequitas Neo Exchange, would provide too great an incentive to the market maker at the expense of existing orders in the book.

Almost all commenters who commented on the MMC functionality were supportive of this feature. They noted that this is a tool that can help market makers and, at the same time, is beneficial to liquidity in periods of market stress. It was noted that the incentive is adequate given the risk and liability market makers take on to fulfill their obligations.

One commenter noted, however, that the MMC will enable the market makers to systematically trade with small incoming orders within the national bid and national best bid and best offer (NBBO), while avoiding large incoming orders. Aequitas Neo Exchange recognized this unintended consequence and responded by amending the functionality of the MMC by removing the ability for designated market makers to submit volume inside the NBBO.

Based on comments received and the change to the MMC functionality referred to above, staff have no further concerns with this functionality.

(iii) Listings and Cross-Listings of Investment Products

We requested comments regarding a process to notify the Commission prior to the listing or cross-listing of novel investment products. We currently have such a process in place for the TSX.

Commenters were generally supportive of the idea, most citing regulatory arbitrage as a primary concern. No commenters took the position that the novel listing or cross-listing notification should not be in place.

As reflected in the commentary to section 2.01 of the Listing Manual, Aequitas Neo Exchange agreed to codify the protocols and standards with respect to the notification process and will notify the Commission of any listing or cross-listing applications of novel products. Staff have no further concerns.

(iv) Emerging Market Issuers – Gatekeeper Concerns

We advised that Aequitas Neo Exchange has agreed not to accept applications to list securities of emerging market issuers (EM Issuers) until it has adopted listing requirements or procedures applicable to these issuers. We asked for specific feedback on the elements that should be included in Aequitas Neo Exchange's requirements or procedures for EM Issuers.

Many commenters specifically agreed (and no commenters disagreed) that additional procedures should be developed by Aequitas Neo Exchange to identify and address the risks associated with the listing of EM Issuers. A few commenters stated that Aequitas Neo Exchange's requirements for EM Issuers should be consistent with OSC Staff Notice 51-719 *Emerging Market Issuer Review*. While several commenters believed that Aequitas Neo Exchange should have the ability to develop its own policies to address EM Issuers, several were of the view that those policies

should be at least as onerous as those applied on other Canadian exchanges or that listing requirements for EM Issuers should generally be consistent across Canadian listing exchanges. Commenters suggested elements that should be included in Aequis Neo Exchange's requirements or procedures for EM Issuers. Each of these recommendations will be considered when Aequis Neo Exchange adopts listing requirements or procedures related to EM Issuers.

(v) Application of the Order Protection Rule (OPR)³

We asked whether it is appropriate for the OPR to apply to the Neo Book, given that this book would have differentiated treatment between its marketplace participants.

The majority of the commenters were supportive of the application of OPR to the Neo Book. They were of the view that OPR should apply to this book as it does to any other transparent marketplace.

A few commenters, however, believed that a market that treats one class of participants differently than another should not be protected.

Staff agree that the Neo Book is differentiating different types of market participants by applying speed bumps and higher fees to the LSTs. However, as we stated above, it is our view that the different treatment of LST orders in the Neo Book does not unreasonably prohibit, condition or limit access to the Neo Book. On this basis, we are of the view that OPR should apply to the Neo Book as it would to any other transparent marketplace.

We also requested comment whether OPR should apply to a new marketplace, in light of *Proposed Amendments to National Instrument 23-101 Trading Rules* published for comment on May 15, 2014 that, if implemented as proposed, would introduce a market share threshold at, or above which, the displayed orders on a marketplace will be protected.

Almost all commenters indicated that OPR requirements should apply to new marketplaces based on existing rules and not on proposed OPR changes that may not come into effect for some time. Requiring Aequis Neo Exchange to be held to a different standard than all other marketplaces was viewed as inconsistent and unreasonable. Commenters were concerned that fundamental market structure rules such as OPR should only be subject to alterations through the normal rule-making process. They noted that it is important to maintain the integrity of the rule making process to ensure that all relevant issues are identified and considered.

Some commenters noted that it may be more appropriate to require Aequis to defer its launch until after OPR amendments have been finalized and implemented, as either option of imposing OPR on the Aequis Neo Exchange or providing some form of exemption will likely result in complications, costs and burden on industry participants.

³ Part 6 of National Instrument 23-101 *Trading Rules*.

At this time, staff are reviewing the public responses received on the proposed OPR amendments and will determine next steps regarding this regulatory initiative. Given the volume of comments received and the issues raised, it is unlikely that the finalization of the OPR requirements is imminent. For this reason, and for fairness and consistency with other marketplaces that have launched in recent years, OPR will apply to Aequitas Neo Exchange in its current form. We are also of the view that, as a matter of fairness, the launch of Aequitas Neo Exchange should not be delayed to accommodate the completion of this particular policy project. That said, Aequitas Neo Exchange will comply with the requirements regarding availability of technology requirements and testing facilities set out in NI 21-101.⁴

⁴ Subsection 12.3(1) of NI 21-101.