TD Securities
TD Bank Group
TD Tower
66 Wellington Street West, 27th Floor
Toronto, Ontario M5K 1A2

Market Regulation Branch
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, ON M5H 3S8
Fax (416) 595-8940
Email: marketregulation@osc.gov.on.ca

via e-mail

August 26, 2014

Re: Application for Recognition of Aequitas Innovations Inc. and Aequitas Neo Exchange Inc. as an Exchange

Dear Sirs and Madams:

TD Securities welcomes the opportunity to comment on the OSC Staff Notice and Request For Comment regarding the Application for Recognition of Aequitas Innovations Inc. and Aequitas Neo Exchange Inc. as an Exchange (Aequitas Application).

TD Securities is a leading securities dealer in Canada and the number one ranked block trader in Canadian equities and options based on dollar value and shares traded. TD Securities also acts as the executing dealer for TD Waterhouse, the largest discount brokerage firm in Canada.

While we are supportive of competition and innovation in the Canadian market, we feel the Aequitas Application as proposed creates an unnecessary level of market fragmentation and complexity relative to the innovation introduced.

- The Aequitas Lit and Neo books have been defined as separate books primarily to establish different make/take fee levels to enable rebate arbitrage between order books. If make/take is eliminated, as proposed by the OSC pilot program, multiple order books will not be required by Aequitas or other marketplace operators.

- The Aequitas Dark book is similar in design to Alpha IntraSpread, which has declined to less than 0.1% market share since the Canadian Dark Liquidity Rules were implemented. We do not expect Aequitas Dark will achieve meaningful market share given the current regulatory restrictions on dark trading.

- The Aequitas Crossing book could be integrated into a trading order book to reduce complexity, as other marketplaces have done.

We question the need to launch four books when one book could achieve the innovation goals while reducing the implementation and operating costs for dealers, and minimizing complexity, fragmentation and operational risk for the Canadian market as a whole.

The launch of three trading books and one trade reporting facility places a significant burden on the industry in the development of routing technology and connectivity, and the extensive testing required for every combination and permutation of order types and messages across all order books. The market fragmentation introduced by the Aequitas model takes the Canadian market in the wrong direction, towards higher complexity rather than simplicity, and limits opportunities for natural orders to directly interact with each other. Launching a single order book would be aligned with the future state envisioned by OSC under the OPR Proposal, which aims to simplify market structure by eliminating rebate arbitrage across multiple order books.

We have concerns on the design of the Neo book specifically, which creates advantages for passive High Frequency Trading firms while offering little corresponding benefit to active retail or institutional orders. The proposed speed bump on active orders allows passive HFTs to fade their quotes to avoid trading with active HFTs, while preferentially trading with less toxic retail and institutional orders. Although natural orders may also rest on the Neo book, passive HFTs are generally the only firms fast enough to re-price their orders within the speed bump delay. The proposed "Derived Orders" offer HFTs an especially effective tool to enable quote fading directly in the Aequitas order match engine. In addition, the higher take fee applied to active HFTs provides further protection for passive HFTs by discouraging active HFTs from accessing the Neo book. The order segmentation within Neo offers HFTs a highly attractive venue to interact with retail and institutional orders, while providing protection from other HFTs.

Similar order segmentation exists on Alpha IntraSpread and marketplaces with inverted fee schedules, but in these cases an economic benefit is provided to the active order, either through price improvement or the payment of a rebate. The Neo model has a stronger form of segmentation than inverted marketplaces, but trades on the Neo book are priced at NBBO with no price improvement or rebate, which creates an outsized structural advantage for passive HFTs. For an active retail or institutional participant, the potential for a reduced take fee or additional liquidity are not commensurate with the benefits granted to passive HFTs on the Neo order book.

We strongly believe that the value of active retail and institutional orders should be returned to the client, either directly through price improvement or indirectly through rebates, rather than being entirely captured by HFTs, as implemented in the Neo design. Aequitas claims to rebalance the market in favour of long-term investors, but as proposed the primary beneficiaries of the Aequitas design are passive HFTs, who are the in best position to capitalise on fee differentials, order segmentation and derived order types, while offering immaterial benefits to the contra-side retail and institutional orders.

OSC Staff have asked for comment on a number of specific issues in the Notice. Our responses follow below:

(i) Benefits and obligations of market makers

The Aequitas Exchange proposes that the market maker benefits apply to the Lit, Dark and Neo books; however, market makers' obligations would only apply to the Lit and Neo books (please see sections 1(d)(ii), 1(d)(iii) and 1(d)(iv) of the Application for a description of the market makers' benefits and obligations in the Lit, Dark and Neo books, respectively). Staff request specific comment on whether it is appropriate to have obligations with respect to the Dark Book and dark pools generally and whether it is appropriate to have benefits in the Dark Book but no obligations.

The Aequitas Application describes market maker benefits that apply to the Lit, Dark and Neo books, but is silent on the specific nature of the market maker obligations. It is impossible to evaluate whether or not the market maker benefits are appropriate without a full understanding of the corresponding obligations. In the absence of any information on these obligations, our default assumption is the benefits provide an outsized incentive to market makers relative to the non-disclosed obligations. In principle, we do not think it is appropriate for obligations in one order book to translate to benefits in a different order book. We are not opposed to the idea of obligations with respect to the Dark book or dark pools generally, but in our opinion any market maker benefits in an order book should be linked to obligations in the same order book.

(ii) Market makers' commitment (MMC)

The Aequitas Exchange proposes to 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 Exchange only (please see sections 1(d)(ii) and 1(d)(iv) of the Application for additional detail). Staff request specific feedback on whether the MMC feature provides too great an incentive to the market maker at the expense of the existing orders in the book.

In addition to our comments on (i) above, we also have concerns on the design of the Market Maker Volume Allocation. As proposed, the Designated Market Maker (DMM) may capture the full size of all incoming active orders up to the volume allocation (initially set to 15% of the traded volume for the security for the day). In cases where the DMM has traded less than 15% of the total volume on the day (which is likely for high volume securities) the DMM would be entitled to 100% of all marketable volume in the final minutes of trading. The end of the trading day is a critical time for participants looking to complete orders or hedge overnight risk. In our view it is unfair for the DMM to capture all marketable volume in the final minutes of the day and prevent other participants from trading into the close.

(iii) Listings and Cross-Listings of Investment Products

The Aequitas Exchange has indicated that a particular focus of the Aequitas Exchange's operations will be the listing of investment funds and other exchange traded products (collectively, Investment Products). One of the ways an issuer can become a reporting issuer in Ontario is to have its securities listed and posted for trading on an exchange. This raises the concern that an Investment Product may become available to the public in Ontario through an exchange listing or cross-listing. In OSC Staff Notice 81-715 Cross-Listings by Foreign Exchange-Traded Funds Staff articulated our view that a cross-listing of a foreign exchange traded fund or other Investment Product securities that are in continuous distribution would generally be considered a distribution in Ontario, requiring a prospectus to be filed. To minimize opportunities for regulatory arbitrage, it is our view that there should be a specific process or protocol put in place to inform Staff of listing or cross-listing applications. The purpose of this protocol would be to allow Staff to assess whether we have in the past recommended or would recommend a receipt for a similar investment fund product offered by prospectus in Ontario. Staff request specific feedback on the listing requirements for Investment Products.

We agree with Staff that a protocol should be put in place to inform the OSC of listing or cross-listing applications.

(iv) Emerging Market Issuers - Gatekeeper Concerns

In OSC Staff Notice 51-719 Emerging Markets Issuer Review (the EM Issuer Review), Staff highlighted the important gatekeeper function to our Canadian markets played by Canadian exchanges. The EM Issuer Review recommended that Canadian exchanges assess whether additional listing requirements are needed to address the risks associated with emerging market issuers (EM Issuers) or whether additional exchange review procedures are required to evaluate whether significant risks are present and how they can be addressed. In response, TSX and TSXV are each currently developing an approach to the listing of EM Issuers. It is our view that Aequitas Exchange should develop its own targeted response to the listing of EM Issuers. The purpose of this exercise is for Aequitas Exchange to develop transparent procedures to identify and address the risks to Canadian markets associated with the listing of these issuers. Aequitas Exchange has agreed not to accept applications to list securities of EM Issuers until it has adopted listing requirements or procedures applicable to EM Issuers. Staff request specific feedback on the elements that should be included in Aequitas Exchange's requirements or procedures for EM Issuers.

We agree with Staff that additional procedures should be developed to identify and address the risks to the Canadian markets associated with the listing of Emerging Market Issuers.

(v) Application of the Order Protection Rule

The issue of the application of the Order Protection Rule (OPR) arises in two ways in the context of the Application. We are soliciting feedback on each issue described below.

(a) Application of OPR to the Neo Book

The Aequitas Neo Book, as proposed, would be considered a transparent market and therefore OPR would apply to the Neo Book at launch. This would mean that all market participants, including LSTs, would be required to direct their orders to the Neo Book if it displayed the best bid or offer. As proposed, the Neo Book will impose a speed bump and higher trading fees on LSTs. It is staff's view that the different treatment of the LST orders in the Neo Book does not unreasonably prohibit, condition or limit access to the Neo Book and Staff request comment on this matter.

However, concerns have been raised whether it is appropriate to require LSTs to route orders to a marketplace that that does not treat these orders in the same manner as all others. Consequently, Staff request comments on whether it is appropriate for a market to be protected where it systematically treats one class of participant differently than another; that is, whether OPR should apply to the Neo Book in these circumstances.

In our view it is not appropriate for a market to be protected if it systematically treats one class of participant differently than another. In addition, we prefer to have the option to not route active retail and institutional orders to the Neo book due to the structural advantages given to passive HFTs under the Neo design, without a corresponding benefit to natural clients.

(b) Application of OPR to new marketplaces

Staff note that, on May 15, 2014, the Canadian Securities Administrators (CSA) published for comment Proposed Amendments to National Instrument 23-101 Trading Rules (Proposed Amendments), including proposed amendments to OPR. In particular, the CSA is proposing to introduce a market share threshold at or above which the displayed orders on a marketplace will be protected. What this means is that the OPR obligations will only protect orders on a marketplace, or its market or facility that has a market share at or above the threshold. In this context, and with consideration to timing, Staff are considering whether the current OPR (without regard to market share) should apply to protect orders on the Aequitas Lit Book and Neo Book (if applicable) at launch, as the launch is anticipated to occur prior to the implementation of the Proposed Amendments. More generally, Staff would like to solicit feedback on whether to interpret and apply OPR such that it does not apply to any new marketplace that launches in the time period between the publication for comment and implementation of the Proposed Amendments. Further, staff request comments on specific benefits to the market or costs and complexities that this approach would introduce.

The Aequitas proposal to introduce four new order books will significantly increase market fragmentation, complexity and operational risk for the Canadian market as a whole, while also imposing high implementation and operating costs for dealers. As the OPR Proposed Amendments are designed to mitigate these issues, we recommend the Aequitas launch be postponed until after the OPR amendments are implemented, or alternatively the Proposed Amendments could be applied to Aequitas on an interim basis to provide relief to the industry. It would be counterproductive and a misuse of industry resources to require all participants to connect to Aequitas at launch if this requirement is reversed shortly thereafter by the implementation of the Proposed Amendments.

We appreciate the opportunity to comment on the OSC Notice and Request For Comment on the Aequitas Application and we would welcome a meeting with OSC Staff to further discuss our views.

Respectfully,

David Panko
Managing Director, Automated Execution Group
TD Securities
TD Tower, 7th Floor
66 Wellington Street West
Toronto, Ontario M5K 1A2