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September 5th, 2014

Market Regulation Branch
Ontario Securities Commission
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To whom it may concern:

Re: OSC Notice and Request for Comment re: Application for recognition of Aequitas Innovations Inc. and Aequitas Neo Exchange Inc. as an Exchange

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 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”), a group of 21 appointed members from amongst the CSTA. This committee has an approximately equal proportion of buy-side and sell-side representatives with various areas of market structure expertise, in addition to 1 independent member. 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 opinion of the CSTA as a whole. The opinions and statements provided below do not reflect the opinions of all CSTA members or the opinion of all members of the Trading Issues Committee. We note that there are members of the CSTA and of the Trading Issues Committee whose firms hold equity positions in existing marketplaces as well as the proposed Aequitas exchange.

The CSTA Trading Issues Committee (TIC) appreciates the opportunity to comment on the proposed application of Aequitas Innovations Inc. and Aequitas Neo Exchange Inc. to be recognized as an exchange pursuant to section 21 of the Securities Act (Ontario) (“The Application”). Given the nature of the Application, our Committee was unable to present many consensus views due to the variety of constituents that comprises our Committee. However, we have responded to the questions that were asked to best of our abilities while attempting to represent the differences of opinion that exist among us. Where possible, we have also discussed the logic used from both sides of an issue.

In addition to the questions that were asked by the OSC, we have also discussed other topics that we believe should be considered in the assessment of the Application. Since the CSTA represent a broad range of practitioners within the Canadian capital markets, we have tried to keep our comments as technically oriented as possible.

While some of our members believe that there are issues of market quality that Aequitas addresses, others believe that it may create excessive complexity. Rather than discussing philosophical topics, we have mostly kept our discussion based on the facts at hand. While this letter may seem to address more points of contention than that of support, it should not be interpreted to reflect a consensus view of the overall merits of Aequitas.

In this letter, we will start by reviewing our response letter to the initial Aequitas proposal filed last year, followed by a discussion of the current proposal by Aequitas, and finally we will answer the questions that were asked by OSC staff.

Initial Proposal by Aequitas filed on June 25th, 2013

On October 3rd, 2013, the CSTA Trading Issues Committee responded to the initial proposal by Aequitas to form a new exchange in Canada. TIC members are pleased to note that there have been a substantial number of additional disclosures relative to its pre-filing details.

Some of the issues that were presented as potentially problematic in our initial response letter have since been resolved in the new Aequitas Proposal. The changes which we consider as positive include a proposed structure that is now consistent with OPR regulations, the discontinuation of the proposed use of the Short-Market Exempt (SME) modifier for identifying HFT participants and denying DEA clients the ability to be Designated Market Makers (DMM) in order to prevent regulatory arbitrage. Aequitas has also modified the priority mechanism for its DMM program in order to limit the amount of volume that is available to DMMs via the Market Maker Volume Allocation (MMVA) feature from an unlimited amount to a maximum of 15% of volume on a given market book. While some TIC members do not agree that a 15% MMVA benefit is reasonable given the information at hand, it is nonetheless a net improvement on the first proposal.

One of the most important issues which many TIC members feel is still unresolved is that lack of public disclosure regarding the details of the proposed DMM program. Due to this lack of detailed information, it remains impossible to ascertain whether the proposed benefits are well balanced with the thus far unknown obligations. With the absence of further information, some members felt that giving DMMs a 15% order allocation priority could be an overly generous incentive. There also has been no disclosure as to the process for selecting market makers, which is of critical significance in a model where there is only one market maker per security. Several responders also felt that the combination of market maker and broker preferencing could increase the difficulties for smaller dealers to execute trades and impact certainty of fills, moving farther away from the traditional values of price-time priority. Finally, there has been no disclosure as to which securities will have a DMM, thus disallowing an assessment of the scope of the DMM program and what the obligations would be as it relates to less liquid securities. Some members question if the benefits provided to the DMMs will incent market making in the securities where it is the most needed, thus addressing a frequently cited failing of the current informal market maker model.

As a final point, our initial letter stated that “*De-prioritizing SME had some support [among TIC members], leading some to question why this was not the chosen solution for Hybrid.*” In the current proposal, some TIC members still have questions regarding: 1) why the order priority for passive non-LST participants is only applicable in the Lit book instead of all the books, including Neo and Dark, and 2) why the speed bump is only applied to the Neo book instead of all the books, including Lit and Dark.

Current Proposal by Aequitas

Market Maker Benefits and Obligations

In the current proposal by Aequitas, the most important topic discussed among TIC members was the Designated Market Maker (DMM) programme and its benefits and obligations.

As a general consensus view, TIC members believe that all marketplaces that currently offer market making programs should be completely transparent to participants about the benefits and obligations of market makers (including greater transparency from those programs already in existence). Since Aequitas has not yet been recognized as an exchange, some TIC members believe that Aequitas should be given latitude as a commercial entity and be allowed to maintain some details of the DMM program as confidential since those details are deemed to be intellectual property. These members also felt that Aequitas would be incented to strike the right balance between benefits and obligations due to both its corporate governance structure and reputational concerns of the shareholders.

On the opposite spectrum, due to the importance of the benefits being proposed for DMMs and the fact that DMMs are a main argument for the value of the Aequitas proposal, many TIC members believe that more transparency should be required from Aequitas on the obligations of the DMMs. These members believe that the following information should be made available to market participants before the value of the Aequitas proposition can be evaluated:

- The specific proposed DMM obligation parameters to weigh directly against the proposed benefits;
- The time of day expectations for when DMMs be actively providing liquidity at the NBB and NBO;
- How the 15% MMVA threshold was determined as a fair volume allocation for the risk the DMMs are expected to assume;
- The policies and procedures for the selection of a DMM for a given security or for a group of securities;
- The list of securities proposed to be assigned a DMM (to assess the breadth of coverage, especially of illiquid securities) and the policies and procedures for the selection of DMMs;
- Details of the Performance Assessment process, including frequency and degree of public disclosure.

Some of our members argue that it would be impossible for Aequitas to furnish details such as the security specific obligations or universe of securities to be covered, as this could only be known once Aequitas is in a position to negotiate in earnest with prospective market makers. Others believe this should be a prerequisite exercise since the benefits to DMMs as proposed are quite significant.

Absent disclosure of specific DMM obligations, contributors provided general feedback. For non-Aequitas listed securities, most members of TIC applaud Aequitas for proposing a market making model that does not provide priority volume allocation to DMM's that do not have visible quotes in the Lit and Neo markets securities.

While we recognize that DMMs would be required to maintain two-way markets with one side of the market at the NBBO at least some of the time, we note that the Market Maker Quote (MMQ) order type will allow DMMs to easily maintain quotes at specified Spread Percentages. Given that an institutions' order routing methodology typically includes sending IOC's at given price level before proceeding to another price level, the MMQ order type will allow DMMs to automatically avoid incoming orders that are not priced at the NBB or NBO, making most obligations that are away from the NBB and NBO as inaccessible in practice.

Some members of TIC have suggested the following improvements to the DMM programme:

- The “% of time a DMM is obligated to quote at the NBB and NBO” and the “Size requirement” should be the most important factors in determining the balance with the MMVA benefit and other benefits.
- Some members believe that it is important to ensure that the generous MMVA benefits are met with stringent Size requirements that would be deemed as “relevant” vs the expected amount of liquidity DMMs could be expected to receive with their priority allocation.
- Many members felt that the proposed MMVA of 15% and any other benefits should only be available to DMMs if they meet their stated obligations (evaluated daily).
- Some members believe that DMM obligations should be evaluated in tandem across securities of different classes to ensure benefits are available in liquid securities only if DMMs satisfy their obligations in less liquid securities.
- Regarding the classification of securities into three volume tiers for the purposes of determining DMM obligations, some members felt that using the average daily volume was not a robust measure since the lower tier of securities would include ETFs (or other securities) that have high quoted volume with little traded volume. If the tiered approach remains, some would suggest that ETFs be completely removed from the assessment of whether a DMM has been allocated a fair balance of securities from amongst the tiers.
- Some members felt that obligations should be segmented for different periods of the day to manage the relative value of the benefits to trading at different points in the day.

Information Leakage

Aequitas proposes some functionality that is meant to segregate order flow among Neo Traders and LST participants. While some members believe that this segregation will be a net positive for Neo traders, others are concerned that the information leakage that will ensue for Neo traders could be more damaging than the claimed benefits.

The first area of potential information leakage involves the proposed functionality of giving Neo Traders order priority in the Lit book. This priority may cause unwelcome information leakage by allowing for the public knowledge that there is a Neo Trader in the market if their order is seen as jumping the queue absent broker preferencing. While receiving allocation priority can be an advantage for some Neo Traders (notably retail orders), some would argue that there needs to be the option for a participant to opt-out of being identified when information leakage is deemed an issue. While it is technically possible

for traders to request two distinct Trader IDs (LST and Neo), this is very hard to implement in practice. Some members of TIC request that a specific marker be enabled to opt-out of being designated a Neo Trader on an order by order basis.

The second area of concern for some TIC members is in regards to the proposed “speed bump” for LST orders in the Neo book. If an LST participant has passive orders posted across multiple marketplaces at once, the speed bump should theoretically allow them to cancel their passive order before they are filled on the Neo Book by another LST participant who actively sweeps the liquidity at a given price point across marketplaces. These members are concerned that giving only active LST active participants a speed bump lets the passive LST participant directly infer that a Neo Trader was an active participant if they (the passive LST) were not able to cancel their order before it was filled, thus leaking the information that there is a Neo Trader in the market. As in the previous example, some members of TIC request that a specific marker be enabled to opt-out of being designated a Neo Trader on an order by order basis. Note that this source of potential information leakage is less worrisome to some TIC members since the act of a participant crossing the spread could in itself imply that they are a Neo Trader since it is a behavior much less typical of an LST trader.

Additionally, there is a strong concern with the potential for information leakage exists in the Dark book due to allowance of Liquidity Providing orders to specify whether to interact with either Retail Only or All Neo Participants. Since the Dark book is constrained to allow incoming orders only from Neo traders, users would interact within the Dark book if they believe that the liquidity that is being provided is worth the implied information leakage that they are Neo traders. We are concerned that the mechanism allows liquidity providers to identify whether active Neo orders are Retail or Non-Retail (thus Institutional). We will illustrate this case in the following example:

A participant sends a Liquidity Providing Order (Order A) to buy 100 shares in the Dark Book with a Contra Election of “Retail Orders”, then subsequently sends a Liquidity Providing Order (Order B) to buy 100 shares in the Dark Book with the Contra Election of “All Dark Liquidity Taking Orders”. If a Dark Liquidity Taking order (Order C) is entered by a Non-Retail Neo Trader (Institution) on the sell side, the Liquidity Providing participant can infer that Order C is from a Non-Retail (Institutional) account if the “All Dark Liquidity Taking Order” (B) is filled and the “Retail Order” (A) is not filled, since Order A should have time priority over Order B.

While a similar iteration of the same functionality currently exists within the Alpha IntraSpread dark facility, IntraSpread is not constrained to accept orders from the equivalent of Neo Traders. Based on its current functionality, IntraSpread only allows for the potential identification of Retail vs Non-Retail orders; it does not allow for the identification of Retail vs Other Investors (Institutions). We would ask that Aequitas either discontinue the counterparty selection function or ensure that all Institutional participants understand the potential sources of risk involved in trading within the Dark Book.

Other Topics

There was broad consensus among contributors that the Size-Time allocation methodology in the Neo and Dark books is very useful to institutional investors. It was also agreed that that it is innovative and beneficial to participants for the Neo Book to aggregate the size of resting orders at each price level. In order to limit information leakage in the Lit book due to the order allocation priority, it was suggested by some members that the Lit book should also have the size of its resting orders aggregated at each price level.

Another topic discussed among some TIC members is the feature of the Neo Book that would allow for undisplayed orders priced (and tradable) within the NBBO to be quoted as visible orders priced at the NBBO. It was felt by some that this feature would add to the price and size discovery process since it would take what was typically non-visible liquidity and make it accessible in the visible markets. Others felt that allowing orders to be posted in a visible market with executions that are priced at a different level is inappropriate, since a participant could simply join a posted order at a given price level on the Neo Book and receive priority by providing a price improvement without disclosing the true price of the order. These contributors believed that the price discovery process could be impaired if prices shown in the market are not reflective of the realized prices, even if those prices are improvements on the visible quote.

Additionally, while it is not specifically addressed in this Proposal, Aequitas is the first marketplace to propose introducing the functionality of trading non-visible orders at the NBBO for common equities where the active order is at least 50 board lots or \$100,000 in value, without first having to fill the volume in a related lit market. Although the regulatory framework as it stands does allow for the functionality, we respectfully suggest that Aequitas should file a separate proposal which outlines this feature in isolation. This feature would not need to impede Aequitas' overall value proposition and the substance of the Application.

In the context of the current Application, we wish to highlight the CSTA's historic position on the issue of trading non-visible liquidity at the NBBO ("at the touch"). In the CSTA's comment letter dated April 20th, 2013 in response to the TriAct Canada proposal to allow "large" marketflow orders to trade with passive liquidity providers at the NBBO, we indicated our belief that the 50 board lot or \$100,000 value threshold, with roots in the Order Exposure Rule, represents far too low a barrier for a "block" in many low-priced Canadian equities. Of the two components of the threshold, the board lot limit, in particular, is a de minimis hurdle for a "block." We do not believe that the practical threshold is consistent with the spirit of the dark rules, which reflects the need to allow larger trades (such as pre-negotiated "blocks") to transact "at the touch". If an "at the touch" facility were extended to all equities at the same thresholds, this would create further disincentives to resting orders in the lit market, in particular for low-priced stocks. This is contrary to the stated objectives behind UMIR Rule 6.6 Provision of Price Improvement by a Dark Order. A more appropriate definition of a "block" could reflect a sliding scale that takes into account both the stock's price point (value per share), and the stock's relative liquidity.

Finally, some members addressed issues in relation to whether resting client liquidity on the proposed Neo and Dark books would be contrary to Best Execution obligations. Since the Neo and Dark Books are designed to either disadvantage LST take orders (Neo Books) or completely restrict LST take orders (Dark Book), those order books are less likely to see active flow from a significant portion of participants within the Canadian market (LST traders). When resting liquidity on a market (as opposed to taking liquidity), a participant is generally indifferent as to who takes liquidity from them at a given price since they are trying to avoid having to cross the spread. If a client rests liquidity on the Neo or Dark Books, they are decreasing their probability of a fill since those markets are less attractive than other Books to LST traders, thus potentially disadvantaging their resting order. While some members believe that Best Execution should include posting a resting order where it is most likely to get filled, others believe that the type of active participant filling the order on a given market should be considered.

Answers to Specific OSC Questions

1. Is it appropriate for market makers to have obligations with respect to the Dark Book and dark pools generally and it is appropriate to have benefits in the Dark Book but no obligations?

Many TIC members believe if order allocation benefits (or any other benefits) are appropriate for the Dark Book and dark pools generally, then obligations should be equally as appropriate. Other members questioned the utility of posting obligations in the dark. Since the Application at hand does not propose any obligations in the Dark Book, we find it difficult to generalize an answer to the overall appropriateness of obligations in dark pools.

The position from the CSTA's response letter to the initial Aequitas proposal still best describes the various views among TIC members in regards to whether benefits are appropriate in the Dark book without any obligations: "Most Committee members felt that it was very difficult to respond to such specifics without further information regarding the [DMM] model. As a general principle, some felt that there were significant fairness issues relating to bifurcating the market making obligation from the benefit obtained. Specifically, some responders felt there should not be benefits without corresponding obligations on any given market. Others maintained that spanning benefits and obligations across multiple books could be a reasonable approach. Responders agreed that more detail and refinement of the proposed program was needed before its merits could be judged."

For those members that believed that DMMs should have some obligations in the Dark Book, the obligations mentioned included randomized minimum quote durations of 3-9 milliseconds (for example) or obligations regarding a minimum size quoted for a given % of time.

2. Does the Market Maker's Commitment (MMC) feature provide too great an incentive to the market maker at the expense of the existing orders in the book?

One of the proposed MMC features allows DMMs to selectively interact with incoming orders within the NBBO that are smaller than the MMC interest (Section 10.03, (2), d), iii), d)). This would enable DMMs to systematically trade with "small" incoming orders within the NBBO, while avoiding "large" incoming orders. NYSE Arca also had an order type with the size avoidance feature (PL Select) which they later discontinued due to the "unintended business consequences" that it created. We would suggest that this specific MMC feature is inappropriate and should be removed. We recognize that Aequitas representatives have acknowledged this issue.

Other than the previously mentioned feature of the MMC, general feedback among respondents indicated that the function should theoretically act in a volatility dampening manner.

3. OSC staff believes that different treatment of the LST orders in the Neo Book does not unreasonably prohibit, condition, or limit access to the Neo Book. But is it 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 isolation, we agree with OSC Staff that a "speed bump" of 3-9 milliseconds does not unreasonably prohibit, condition, or limit access to the Neo Book. If OPR applies to the Neo Book, it will only limit LST Traders from being able to take liquidity at a given level, and will not force them to wait for a fill to move

on to other price levels or markets. The worst case scenario for an LST Trader is to not get filled on an order that is sent to the Neo Book before it is re-priced.

We also agree with the OSC Staff that (in isolation) a “high active fee” also does not unreasonably prohibit, condition, or limit access to the Neo Book. Since the active take fee that is being proposed is simply the highest active fee that is currently being applied in the Canadian market (notably by the TSX), this does not seem to be an unreasonable measure.

On the assumption that different treatment of the LST orders in the Neo Book does not unreasonably prohibit, condition, or limit access to the Neo Book, it would be appropriate for OPR to apply to the Neo Book. However, there is continued debate as to whether the systematic treatment of one class of participant vs another is appropriate in general, particularly where order protection is given.

Some contributors feel that Aequitas’ determination that an active LST orders is less desirable or potentially predatory in nature than a passive LST orders (by imposing a “speed bump” and a “high active fee”) may not reflect the realities of a multiple-marketplace environment and thus LST active orders should not be disadvantaged without detailed rationale or factual data.

Some members also expressed a concern that the type of segmentation that is being proposed may set a precedent to segmentation in the lit markets by the nature of the strategy or type of investor (for example, retail vs. institutional). Under the same logic, another protected market could theoretically impose constraints limiting the speed of institutional order flow instead of LST order flow, allowing participants protection from being adversely selected by large orders. While we do not believe that a marketplace would actually propose this, we must still be aware of the type of precedent that this proposal may be creating.

Most members of TIC strongly believe that the regulatory approval of a proposal or amendment that allows for a specific application of order segmentation should not automatically apply as a precedent for other proposals or amendments dealing with any type of order segmentation (similar, identical or completely different) than those already proposed or enacted. There is concern by some that this type of proposed segmentation could be used as a precedent for other proposals, leading to escalating complexity and an order segmentation regime among marketplaces. This outcome would be seen as contrary to the spirit of fair access requirements.

4. Should current OPR rules 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.

The Proposed Amendments to OPR have acknowledged that there are issues with the captive consumer phenomenon that OPR creates. Some TIC members believe that any new marketplace applications should be delayed until after the implementation of the new Proposed Amendments, especially considering that the most important costs for participants are the initial implementation of connectivity to a new marketplace and the integration into the participant's systems. Other TIC members believe that best practices in administrative law and regulatory rule-making should be respected, and that OPR rules should apply to Aequitas if it is ready to launch before the implementation of the Proposed Amendments.

When addressing this question, many members also felt that it was important to mention that the Aequitas application did not take the opportunity to show leadership on the issue of exchange liability. This has been a longstanding point of concern among all our members. While this is not an issue that is particular to Aequitas, it would have been viewed as a point in favor of Aequitas being protected under the current OPR rules.

Conclusion

In our original response letter to the Aequitas Proposal last year, “the general view was that the stated goals of Aequitas to reduce the impact of speed and level the playing field for “natural” investors are worth pursuing through a competitive offering.” While many members of TIC believe that the goals of the proposal are laudable and potentially valuable, some still have questions regarding the value proposition to institutional investors and whether the current proposal adds unnecessary complexity to the Canadian marketplace. Others trust that the corporate governance structure of Aequitas will solve any ongoing conflicts that could be seen imbalanced against investors.

We appreciate the opportunity to comment on this matter.

Respectfully,

“Signed by the CSTA Trading Issues Committee”

c.c. to:

OSC:

Mr. Howard Weston, Chair and CEO
Ms. Maureen Jensen, Executive Director & CAO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation
Ms. Ruxandra Smith, Senior Accountant, Market Regulation
Mr. Paul Romain, Trading Specialist, Market Regulation

AMF:

M^e Anne-Marie Beaudoin, Secrétaire générale

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Ms. Susan Wolburgh Jenah, President and CEO
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Mr. Jos Schmitt, CEO
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