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Ontario Securities Commission
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September 5, 2014

**Re: APPLICATION FOR RECOGNITION OF AEQUITAS INNOVATIONS INC. AND
AEQUITAS NEO EXCHANGE INC. AS AN EXCHANGE - NOTICE AND REQUEST OR
COMMENT**

Scotia Capital Inc. (“Scotiabank”) appreciates the opportunity to comment on the application for recognition as an exchange by Aequitas Innovations Inc. (“Aequitas”) and Aequitas Neo Exchange Inc.

As we stated in our original comment letter on the Aequitas proposal, dated October 4th 2013, Scotiabank supports innovation in the Canadian capital markets, particularly when it serves to further stable, fair and efficient markets. We expressed our disappointment that recent innovation by Canadian market operators had mainly taken the form of changes to trading fee models rather than attempts to improve the trading experience for Participants

We continue to be supportive of the spirit of the Aequitas proposal and its attempt to address some significant issues with current Canadian market structure including excess intermediation by HFTs, effectiveness of current market making models, and high execution and technology costs. Specific ideas such as derived orders, the Neo quote feed, and size-time priority are interesting and potentially positive for the market. We do however have some concerns about the impact of the proposed implementation and are not clear that it will achieve its stated goals. In particular we are concerned about the overall complexity of the proposed books and order types.

With respect to the specific comments sought in the RFC:

(i) Benefits and obligations of market makers

We do not have an issue with market makers receiving some benefit in the dark book, while their obligations only apply in the Lit and Neo books. Our core concern with the market maker model is that it strikes a reasonable overall balance between benefits and obligations. In our view, the only way to do that is to provide full transparency into the process – publishing the evaluation criteria, scorecards, trading volumes and other relevant metrics. This should help demonstrate the benefits being assigned are reasonable relative to the services being provided.

(ii) Market makers’ commitment (MMC)

Given that the market maker commitment only kicks in when there are no orders from other parties at that price, we do not consider it to be too great an incentive. Again, disclosure of the use of this feature in relation to the overall service provided by a market maker would allow an accurate assessment of the relative value and fairness of this benefit.

(iii) Listings and Cross-Listings of Investment Products

We are supportive of the staff recommendations that a process be put in place to notify staff of cross-listing applications. We also believe that consistent requirements and processes should apply across all listing markets.

(iv) Emerging Market Issuers - Gatekeeper Concerns

Again, we are supportive of the staff recommendations that Aequitas be required to develop an appropriate procedure for listing of Emerging Market issuers. We would recommend that a minimum set of requirements and procedures be required for all listing markets.

(v) Application of the Order Protection Rule

LST / Neo Trader Definitions

In general we have concerns about attempts to identify types of HFT participants and specifically penalize their orders as a way to improve market quality. We would prefer to focus on designing systems that penalize negative behaviours and incent positive behaviours without trying to divine the motivation or strategy behind a specific order.

While we are pleased that the Aequitas application is no longer proposing to use the SME marker to differentiate HFT participants, their replacement definition of Liquidity Sensitive Traders suffers from the same potential problems as the SME marker.

The LST system creates a compliance hassle and encourages gaming. For example, it seems like an HFT account which runs multiple strategies some of which carry net positions would not be considered an LST. HFT participants often run multiple strategies concurrently so layering a latency arb strategy together with an ETF arbitrage strategy that carries positions could result in the net trading not being considered LST.

Applying a small speed bump to all incoming orders (as is being done by IEX in the US) should solve most latency arbitrage issues in a much more straightforward way. The proposed size-time based priority can also blunt the advantages of low-latency systems. If these features are implemented well, further discrimination against HFT traders seems unnecessary in our view.

If the Aequitas proposal is allowed to proceed, we would appreciate some clarification on the implications for fair access. In particular, will marketplaces be allowed to provide differential access to certain categories of market participants and if so will there be guidance on the types of segmentation that will be permitted. For instance would differential access based on institutional versus retail orders, particular trading strategies or sets of order flow characteristics be permitted? We would also seek clarification on what would be permitted in protected versus

unprotected marketplaces. There are significant potential implications to allowing differential access and segmenting trading in this way and we would prefer to see the principles addressed up front rather than waiting for marketplaces to bring forward various specific proposals.

(v)(a) Application of OPR to the Neo Book

We do not believe that it would be appropriate to require LST traders to access the Neo book as part of their OPR responsibilities given the differential access that they would have to that book. The delay and materially different net price they would realize in trading on Neo make the requirement unreasonable. Though there would be a certain irony in having LSTs forced to trade against a market where they are at a speed disadvantage and pay high fees, we believe that markets that do not provide full and equal access to all should benefit from protected status.

(v)(b) Application of OPR to new marketplaces

We are supportive of the proposed changes to the OPR framework and believe that they will address many of the issues with our current market structure. There are however significant implications to those changes for the market, including technology, market data, compliance monitoring and other potential technology issues. Our view as to whether the lit book should be given protected status hinges to a large degree on when those challenges will need to be addressed.

All things being equal, we are inclined to extend protection to the Aequitas Lit Book since they had started the process of application prior to the publication of the proposed OPR changes.

We are however concerned about a rush of other venues applying for recognition and protected status prior to the OPR changes going into effect (assuming they proceed largely as proposed). We would therefore not be supportive of other venues being approved and given protected status prior to the rule changes going into effect. If it is the OSC's determination that from a fairness perspective they would need to approve similar applications prior to the pending rule changes becoming effective, then we would prefer to see Aequitas not be extended protection to avoid setting that precedent.

We would also note that we are assuming that Aequitas is proposing to launch substantially before any OPR amendments would go into effect. If those timelines were going to be within six months of each other then we suggest it would be more reasonable to have the Aequitas Lit Book be unprotected on the basis that it would become unprotected once the rules went into effect anyway.

Dark Book

The rule that lit orders must trade ahead of dark orders becomes less meaningful if marketplaces start defining their dark functionality as a separate order book rather than being integrated into the lit book(s). Functionally we suspect there may not be that much difference between the two approaches as the SOR is likely to check the dark book for liquidity before proceeding to the lit book, but by calling the dark a separate trading book large dark orders can print ahead of orders in the lit book at the same price.

We are not sure that this is inherently a problem, but it could encourage other marketplaces to needlessly create new dark books. If this is allowed it may be worth considering changing the regulation to allow large sized dark orders to trade ahead of lit orders on a marketplace to avoid giving an advantage to this format. We would note that generally we prefer that lit orders be given priority to encourage price discovery but in this case that priority has already effectively been circumvented.

Better Disclosure

In general, most of the issues we have with the proposal relate to its complexity and lack of disclosure. It appears however that the market is likely to launch largely as proposed so we would focus instead on the need for better disclosure. We acknowledge that there may be competitive concerns about releasing some details too long before launch; however we would strongly encourage that better disclosure of details of the market making program and the size-time priority determination method be required prior to launch.

Other Comments

There are a few other concerns that we wanted to raise:

- The “national best” order type working differently by security strikes us as needlessly complicated and likely to cause confusion.
- MatchNow is moving away from midpoint call randomization to immediate matching. The call can be gamed anyway by having a SOR send an IOC first to trigger an immediate match, then following up with a mid-point order if not filled. We’d like it to at least be an option to trigger a match immediately to avoid this needless complication.
- We are disappointed to note that the proposal does not do anything to address the issue of exchange liability that has been a significant concern in the market recently. Other than some minor exclusions, the proposed Member Agreement requires members to fully indemnify Aequitas for any losses and does not provide a mechanism for the exchange to take any liability for its actions or system failures. We continue to believe that the lack of any liability by Canadian marketplaces is not desirable from a policy perspective and that a mechanism to better align the risk mitigation interests of market participants and marketplaces is required.

On balance, we believe that the Aequitas proposal should be allowed to proceed. Though we continue to have some concerns which we hope will be addressed, we commend Aequitas for their effort to bring true innovation to the Canadian equity markets.

As always, we appreciate the opportunity to comment on this issue and would be pleased to provide any more details if desired.

Sincerely,

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