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September 27, 2013

Market Regulation Branch
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Via email to: marketregulation@osc.gov.on.ca

Randee Pavalow
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Aequitas Innovations Inc.
Via email to: randee.pavalow@aequin.com

Re: OSC Staff Notice and Request for Comment regarding proposed structure of Trading Facilities for a new exchange to be established by Aequitas Innovations Inc.

Dear Mesdames and Sirs,

We are writing on behalf of the institutional division of RBC Dominion Securities Inc. ("RBCDS"), in response to the above noted OSC Staff Notice and Request for Comment ("Notice" or "Request for Comment"). RBCDS welcomes the opportunity to provide comments on the important issues raised in this request for comment. RBCDS is responding to this notice, not only to address the questions posed by Staff, but also due to the importance of the issues facing the markets and the need for regulators to hear perspectives from a diverse array of stakeholders.[1]

For the past several years, RBCDS has taken what we believe to be a principled stance on the rapid evolution of our markets. While our organization has the scope and resources to respond to technological and market changes in a

[1] In the interest of full disclosure it should be noted that RBC Dominion Securities Inc. is a minority shareholder in Aequitas Innovations Inc.

myriad of ways, we have chosen to take what we believe to be the long-term view in how we conduct our business and service our customers. While technology has brought many positive changes to financial markets, we believe it remains important for stakeholders to be constantly mindful of the big-picture and long-term impact of these changes on both institutional and retail investors.

Like many industry peers, during the past several years we have observed some troubling trends in market structure, and have expressed our concerns to regulators. As is well known, some other industry participants have expressed divergent perspectives. Reconciling these diverse points of view while grappling with the rapid evolution and growing complexity of our markets is no easy feat, so it is of little surprise that regulators continue to struggle to independently identify and address these challenges.

Given the prevailing market structure issues that we assert have contributed to recent erosion of investor confidence, RBCDS began conversations with several industry participants last year and found many stakeholders share our concerns. Together, we shared different ideas on what might be done to address the issues while preserving the positive impact of technology. We also carefully considered the context of regulations which are undoubtedly intended to preserve and uphold principals that are important to the long-term health of our markets. Aequitas is the result of these broad discussions.

Aequitas management has unique and significant challenges. They have been asked to work with regulators to identify ways to address the harm that its shareholders believe is occurring in today's equity markets while building a profitable business model and respecting the spirit and intent underpinning the regulatory environment in which it proposes to operate.

RBCDS appreciates the thoughtful review of the background issues that Staff embedded in its notice. To fully appreciate and address these matters, it is important to understand not just the letter of regulations, but also the intent and history behind them. With this in mind, we have identified meaningful gaps between our interpretation of the intent of existing market regulations and the reality of today's marketplace functionality in practice. Among them:

> **Liquidity:** While today's marketplaces are incented to foster speed, volume and narrow quotes, most market participants readily acknowledge the ongoing disconnect between traded volume and liquidity that is accessible to investor activity and critical to the success of issuers.

> **Transparency:** Many seasoned professionals in today's marketplace who work on behalf of everyday Canadians find markets unnecessarily complex, difficult to navigate and geared to short-term intermediation. By contrast, the uncommitted intermediaries who operate in these same markets thrive on the same complexity.

> **Price Discovery:** Often mischaracterized by some to infer speed and narrow quotes, price discovery actually refers to the overall efficiency of

stock prices. Our analysis[2] of market trends in Canada spanning almost two decades has revealed a significant increase in short-term price volatility which we believe underscores degradation in price discovery that ultimately represents a tax on the savings of everyday Canadians.

Fairness: While trading venues continue to argue that everyone can equally access their services, the nature and focus of these services has implicitly put natural investors at a disadvantage while continuing to emphasize greater volume through intermediation. We believe the result represents a tax on networks that service natural investors, and through diminished execution quality, on the savings of average Canadians.

Integrity: While a significant portion of HFT flow is arguably problematic simply due to their collective and highly similar behavior, the high-speed and high message volume nature of their activity also opens the door to various manipulative and abusive trading strategies which remain difficult for regulators to detect and police. We believe that HFTs' problematic group behavior and ability to engage in manipulative and abusive strategies continue to undermine investor confidence.

Competition: With eight lit venues operating in Canada today and more on the way, their collective focus continues to be on encouraging intermediation under the integrated protection of imperfect (albeit well-intended) regulation. We do not believe this constitutes progressive competition, but rather the perpetuation and growth of a system fundamentally flawed in its ability to serve investor interests.

With regards to the future plans of the OSC, we welcome the forthcoming review of maker-taker, market data fees and regulations such as OPR. We also support the efforts of regulators to seek out and deal with untoward behavior that compromises the integrity of equity markets. However, while regulatory action may well offer relief from the challenges faced by our markets in the future, it remains that there is currently little consensus on the way forward and continued risk of more unintended consequences from regulatory intervention.

The Aequitas proposal offers solutions to encourage disciplined participation from short-term intermediaries through reasonable controls on their behavior. Moreover, it offers the opportunity for such parties to stand up and assume a meaningful obligation to provide reliable liquidity to investors in a fair and responsible fashion.

Through its proposed market structure, Aequitas does not seek to fully restrict access by any party. Likewise, it does not undermine the ability of any participant to seek out OPR trade-through protection on any number of existing marketplaces – or on its own lit venue. Its pricing models will offer a competitive response to the cost concerns of the dealer community. Aequitas seeks to offer matching models which will help restore the ability of natural investors to obtain passive fills. Finally, it seeks to democratize access to best-in-class routing

[2] https://www.rbccm.com/about/file-704108.pdf

technology which will provide better tools for all dealers to seek out best prices for their clients. Above all, as evidenced by this very comment process, it seeks to do these things with unprecedented co-operation and progressive input from market stakeholders.

We believe that Aequitas offers a truly competitive solution that can exist, with some accommodations, within the existing regulatory framework. Forcing Aequitas to fit alongside the flawed marketplace competition that exists cleanly in today's regulations would be a mistake – meaningful competition and productive innovation often challenge existing regulatory norms. We encourage regulators to consider the responses of all market participants carefully.[3] Likewise, we expect Aequitas to make reasonable accommodations based on feedback of the community – provided such recommendations can be justified in better service of either long-term investors or issuers.

Once again, we appreciate the opportunity to respond to this Request for Comment and would be happy to offer further perspective as needed.

Sincerely,

Greg Mills
Managing Director
Co-Head, Global Equities
RBC Capital Markets

[3] RBCDS has provided specific responses to the questions posed by regulators in Appendix A of this letter on pages 5-17.

APPENDIX A

Question 1: Should OPR apply to all visible markets and to all orders displayed on those markets, or are there circumstances where the application of OPR should be limited?

No, for the reasons set out here. To address this question effectively, it is important to understand the spirit and policy goals of OPR. To our understanding, its spirit has generally been expressed as a duty owed to the marketplace. More specifically, the CSA expressed four stated policy goals for OPR:

1. balancing regulation and competition among all types of marketplaces;
2. recognizing and supporting the role of retail participation in the market;
3. promoting greater order interaction;
4. encouraging innovation[4].

Of note, most of the 29 comment letters filed in response to the CSA Discussion Paper 23-403 in 2005 focused on the potential for damage to investor confidence and perceptions of fairness by the occurrence of trade-throughs – this, again underscores protection as a right afforded (as incentive) to visible limit orders and generally the importance of investor confidence to the health of secondary markets.

Equally important to consider is, in practice, how OPR has combined with maker-taker and marketplace fragmentation to lead to outcomes meaningfully different than the above-stated spirit and policy goals. Here we have several observations:

(a) Perceived competition amongst marketplaces has been based on the limited dimensions of fee/rebate models[5], speed, geographic location and HFT-friendly order functionality. This evolution has encouraged fragmentation, complexity and intermediation. These trends contribute to higher trading costs for investors with increasingly questionable benefits, as well as introducing a host of agency conflicts in order routing decisions.

(b) Posting of visible limit orders by natural investors and real market makers has become increasingly problematic. Long order cues induced by the speed primacy of HFTs have put other participants at the back of the line. Similarly, display of any but the smallest limit orders in the most careful way are now associated with increased information leakage. The result: investors are less inclined to post orders and are generally expected to just pay the spread. Put simply, we believe that OPR has led to less investor confidence to post visible limit orders – not more. This is, of course, entirely contrary to our understanding of the policy goals of OPR.

(c) Having been disenfranchised from posting limit orders, investors are now forced to actively interact with HFTs across each price increment (due to full

[4] 23-403 - CSA Discussion Paper - Market Structure Developments and Trade-Through Obligations

[5] Notably, not fee competition based on the cost of the marketplace operators ability to manage cost but rather based upon a "pass-through" of a subsidy from liquidity takers.

book order protection) and every market which, for many, amplifies the well-known problem of "liquidity fade" for all but the smallest orders. The result: while displayed quotes are usually one price increment wide, these spreads are practically inaccessible for many investors. This leads to a combination of more market impact and increased opportunity cost for natural investors.

(d) The highly generic and near-simultaneous response of HFTs to all but small sized orders not only leads to liquidity fade (due to both cancellations and active HFT competition for resting liquidity), but has driven a material degradation of price discovery in the form of a doubling in relative short-term intraday volatility[6]. We believe this behavior is highly indicative of a positive feedback loop[7] which continues to cost investors while also damaging their confidence in equity markets.

(e) The combination of systemic complexity, the volatility inducing and uncommitted collective behavior of HFTs, and an environment that neglects committed market-making has led to several notable and high-profile events characterized by market infrastructure failures and/or extreme single-stock/market-wide volatility. These incidents further chip away at investor confidence in equity markets and have led to a mistaken regulatory focus on band-aid coping mechanisms (such as single stock and market wide circuit breakers) rather than a focus on addressing root causes.

Based on the above observations, we turn to the current initiatives outlined by Staff in Section II. D of the Notice and the assertion that the current review of OPR might address "in part a number of the issues raised with the current market structure." Here, we question the validity of the two sole benefits of OPR cited by Staff.

First, based on RBCDS's experience, "efficiency gains from the virtual consolidation of fragmented marketplaces" have not materialized. In fact, such optimistic claims as to the benefits of OPR have been dismissed by a host of market participants since the onset of multiple markets. Further, the very success of our latency normalized smart order router technology and our aforementioned research on intraday volatility are both indicative of the inaccuracy of this claim. Put simply, the virtual consolidation of fragmented markets is, to many, a myth.

This leaves us with the second claim, that of "increased investor perception of a level playing field resulting from their visible better-priced quotes trading ahead of other inferior-priced orders." In our view, this is the main plausibly defendable benefit of OPR. The regime now in place has indeed acted to ensure that investor orders are not traded-through. However, the problems cited in (b) through (d) above certainly call into question the cost at which this benefit has been won.

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[6] https://www.rbccm.com/about/file-704108.pdf

[7] *Positive feedback* is a process whereby the effect of a relatively small disturbance on a system has a tendency to be amplified. That is, A produces more of B which in turn produces more of A. Positive feedback can be observed in chemistry, biology, electronics, climatology, psycology and finance. Examples include: panic, stampedes, a run on banks, feedback in a PA system.
(see: http://en.wikipedia.org/wiki/Positive_feedback)

With this, we would turn to the assertion that the current regulatory review of OPR might address some of the issues we describe. Here, RBCDS has a number of concerns:

- regulatory action to resolve the complex market structure issues will invariably be very slow to come – while the issues that face the industry today are, in our view, urgent and pressing;
- as supported by the unintended consequences of OPR to date, the complexity of the issues at hand and the certainty that parties with interest in the status quo will continue to resist change, we believe regulators will struggle to fully address the problems faced by a number of market stakeholders;
- ultimately, regulation is not a substitute for innovation and competition – where possible, innovation that drives competition and choice should be seen as a desirable alternative with a meaningful role in helping to address market structure and market quality issues.

Considering the above-noted background, we would argue it is understandable why marketplaces or participants would seek to limit the application of OPR. Our view is that Aequitas' proposed Hybrid book would, in fact, provide an outlet for competition; and that the choice it proposes to offer does not undermine the spirit of OPR, but rather can exist alongside it and might well prove to inform future evolution of the rule. As a reminder:

- the Hybrid book would be bound by the NBBO and as such would not trade through better priced orders – thereby upholding the spirit of OPR;
- the spirit of OPR was clearly to *incent* the posting of visible limit orders with protection, not to force mandatory protection on all visible limit orders – extension in this manner undermines choice and innovation;
- similar to the OPR incentive to post visible limit orders, the Hybrid book seeks to offer an alternative incentive by providing the opportunity to interact exclusively with natural investors – thereby offering protection from often problematic interaction with non-investor orders, in particular active HFT;
- passive users of the Hybrid book would be sophisticated in nature and disclosure would be robust to ensure it is clearly understood that orders resting in Hybrid are not protected under OPR;
- choice will continue to exist in the form of several protected marketplaces (including Aequitas Lit) where protection under OPR can be obtained.

Based on the above, we believe it is clear there are circumstances where the application of OPR should be limited and that the proposition behind Aequitas' Hybrid book is an excellent example of such circumstances.

Question 2: Should OPR apply to Hybrid? Should it continue to apply at least with respect to active non-SME orders that are not restricted from accessing the best-priced displayed orders on Hybrid?

No, OPR should not apply to Hybrid. See response to Question 1.

While it would clearly be in the commercial interest of Aequitas to have Hybrid orders enjoy protection for all natural liquidity takers, RBCDS believes the value proposition of Hybrid should be allowed to stand without the need of regulatory protection. We believe that shelter from predatory HFT should prove attractive to resting participants. Likewise, active orders will be incented to route to Hybrid based on displayed liquidity, attractive economics, and the possibility of price improvement.

In general, given the functional nature of the Hybrid book, any posting of larger passive retail orders there would be limited and based on best execution considerations only. Similarly, we think institutional buy-side investors will selectively utilize the Hybrid book where it is consistent with their trading strategy. Finally, Hybrid will prove attractive for SME participants (including arbitrage players, HFTs and Aequitas market makers) who are willing to forgo the rebate widely available in other lit markets for the opportunity to interact with natural investor flow. Overall, we feel the parties posting liquidity in Hybrid will be sophisticated in nature and, as such, their choice to post resting liquidity there should not be considered problematic from a confidence perspective.

Question 3: If Hybrid is implemented as proposed, how should the best-priced displayed orders on Hybrid be treated for the purposes of consolidated display requirements, and why?

We do not believe that Hybrid quotes should be incorporated into the consolidated quote display of the Information Processor ("IP") as it is proposed to be a non-OPR protected venue. While we understand that the obligation to provide information to the IP pre-dates OPR, we believe that the combined NBBO of the other lit venues in Canada (including Aequitas Lit) will provide a more than sufficient basis for the purpose of trading and investment decisions. Consumption and display of the Hybrid book's available liquidity may be warranted or desirable based upon a particular participant's needs. Notwithstanding our view, if it is determined based upon a strong consensus view from other participants that Hybrid quotes should be included by the IP, then we would advocate that they be clearly identified as non-OPR protected.

Based on the above, we would suggest that if it is determined that provision of Hybrid quotes to the Information Processor is not required, we would expect Aequitas to seek an exception to Section 7 of NI 21-101 as appropriate.

Question 4: What should the appropriate reference price be for determining whether a dark order on any other market has provided minimum price improvement as required under the Dark Rules – the Away NBBO or the NBBO that includes a Hybrid best bid and/or Hybrid best offer? Does the answer to this question depend on whether or not OPR applies to Hybrid?

OPR protected lit markets are the appropriate reference price for NBBO. As the Hybrid book will display better priced orders than the NBBO, this question raises the issue as to if the existence of Hybrid should set a higher bar for dark markets as it relates to requirements to provide minimum price improvement. We would argue that the Dark Rules have already placed a burden on these marketplaces in terms of their price improvement requirements and, as such, raising the bar further without a clear objective would make little sense. We feel that price improvement standards for dark markets should remain based solely off the lit quotes of OPR protected lit markets.

Question 5: How should fair access requirements be applied with respect to access to visible marketplaces?

Fair access should be applied with respect to visible markets in recognition of the parties they should be serving (investors and issuers) and the importance of fostering *healthy* participation of other parties (market makers, speculators, arbitrageurs, etc.). This should come with full discretion to judge the reasonableness of any proposed restrictions in light of the aforementioned considerations and with due consideration of the limitations of regulators and the associated need to foster choice through marketplace innovation.

Question 6: Should visible markets be fully accessible or, like dark pools, should access restrictions be permitted? Why? What are the criteria that should be used to determine if the differences in access are reasonable? What impact, if any, could restricting access to the best displayed price have on confidence and market integrity?

We believe restricting access to best displayed prices in Hybrid will improve market confidence, quality and integrity – and we would not support it otherwise. The proposed restriction seeks to recognize the critical importance of natural investors as one of the two primary parties that secondary markets *must* serve. Aequitas also seeks to control the collective negative behaviors of a group of participants whereby harm has and continues to be demonstrated. We emphasize that all parties which Aequitas seeks to control will equally enjoy the protection afforded by these restrictions as passive participants.

As stated, fair access restrictions to any marketplace, lit or dark, are subject to a test of reasonableness under 21-101. Accordingly, regulators need to thoughtfully consider the impact likely to be realized by any proposed restrictions. We believe this to be true in considering access restrictions in both dark pools and in displayed marketplaces. However, contrary to the notice, we can cite some Canadian

precedents of what was historically deemed reasonable restrictions on even lit fair access:

- Historically, TSX maintained anti-scooping rules to prevent pro traders from moving the COP during the two minutes prior to the open – this was justified due to the risk of shutting out client orders. Interestingly, this rule was recently eliminated by TMX precisely because DMA and HFT clients now have "better access to trading and real time data."[8] In our view, by doing this the TMX indirectly acknowledged the reality that HFT participants do have an advantage over traditional participants.
- Through participation against only "non-BK" market flow, market makers on TSX can selectively participate against non-recurring mostly retail-like flow while generally avoiding HFT and institutional flow.

In order to determine what criteria should be considered in judging what is reasonable, we believe the starting point is to understand the fundamental social purpose of secondary markets. In RBCDS's view, this is to equitably serve the liquidity needs of its primary and most critical users – investors (providers of investment capital) and public issuers (consumers of investment capital).

Promoting short-term speculators and arbitrageurs has historically been viewed as an important ingredient to service primary users by fostering price discovery and supporting the need for continuous liquidity. That said, we believe that regulators should not lose sight of the risks posed by over-incenting this activity and the obvious conflict that marketplaces have in this regard.

RBCDS is of the view that fostering the confident participation of primary users must always be of paramount concern. In contrast, while participation of speculators and arbitrageurs is important, the activities of these parties must be managed to ensure that they do not introduce inefficiencies (such as excessive intermediation or increased volatility) and/or disruptions which serve to undermine the confident participation of the market's primary users. Unfortunately, such problems have been the hallmark of Canada's marketplace evolution, and that of many other marketplaces around the world, during the past decade.

We believe that unfettered and fair access for natural investors to displayed markets should be preserved and protected. Segmentation or restrictions between different classes of investors, while having some reasonable application (based on needs), must be carefully considered even in dark venues and we have difficulty envisioning a justifiable investor segmentation model in lit markets. The one exception we see here is as it relates to fee concessions.

In recognition of the role that economics continue to play in retail routing decisions, we believe it is reasonable for venues to offer concessions to attract this flow.[9] We also acknowledge the need to ensure that pricing mechanics are not used as an unreasonable barrier to de facto exclude certain investors (say institutional parties)

[8] http://www.tmx.com/en/pdf/Proposed-TSXRuleAmendments_Oct2011.pdf

[9] Specifically, we support lit pricing models that finance concessions from a venue's own economics.

from accessing a marketplace. Here, reasonableness ultimately requires the use of judgment based on case specific facts.

Turning to non-investor marketplace users, we again underscore our appreciation of the role of these players. However, we would highlight their historical track record to sometimes introduce disruptive behavior. Of course, many would suggest that this should then be dealt with through regulation that focuses on policing bad behavior. While we acknowledge that regulatory intervention to address undesirable behavior is an option, the application of regulations to monitor and control such behavior can be problematic.

The first obvious problem in the use of regulation is that it relies on regulators to constantly keep up in their ability (in terms of technology tools, analytical ability and supporting rules) to stitch together the facts that identify and prove a negative behavior. This can be far more problematic when the parties being policed are many in number, highly automated and highly active, access multiple and complex market eco-systems[10] across multiple Direct Electronic Access ("DEA") providers and focus on broad lists of active securities. Given these conditions, consistently identifying and proving negative behaviors can be near impossible for regulators.

Another problem arises when focusing on behavior. When a negative behavior of a market participant is restricted to one or a few parties and the willful intent and benefit to engage in that behavior can be observed or inferred, then regulatory action to prohibit and ban it is more straightforward. However, this is not always the case.

Negative market outcomes can also arise from the collective behavior of a group of individual parties – each arguably acting out of rational self-interest – whereby the conditions around them and their tendency to respond in a similar fashion drive the negative market quality outcome. In this case, the ability to infer ill intent to a negative outcome is impossible – especially as the individual parties can be argued to have been acting out of self-interest. Nevertheless, the damage to investor confidence and market integrity can be as great if not more severe due to the collective nature of these actors (again see: positive feedback loop[11]).

Based on the above, we believe it is reasonable to argue that access restrictions on non-investor participants can be supported if their actions are seen to cause harm to investors and issuers. Access restrictions on groups exhibiting problematic collective behavior can be further supported based on the aforementioned difficulties to use regulation as a remedy for the harm being caused.

Question 7: Are the access restrictions proposed for Hybrid consistent with the application of the fair access requirements?

Yes. While "reasonable" restrictions to the fair access requirements to date have been mostly limited to dark venues, we see no valid reason why the reasonableness

[10] For example, in recent conversations with a Canadian marketplace operator we discovered that their message throttling infrastructure seemingly exists entirely outside the view of IIROC's surveillance systems. The implication here is that malicious activity such as quote stuffing could in theory be occuring which IIROC would find difficult if not impossible to detect.

[11] See Footnote 7, Page 6.

standard cannot be applied in a displayed market. On this basis, and based on the views we express in response to Question 6, we believe the access restrictions proposed for Hybrid are consistent with the application of the fair access requirements.

Question 8: Is the SME marker an appropriate proxy to identify the behaviours Aequitas seeks to restrict?

While possible that a better proxy may emerge in the future, we believe that the SME marker is both a reasonable and workable proxy. To the extent that there is a perception that SME is not being uniformly applied across the dealer community, we suggest that IIROC move to provide clarity through additional guidance on the appropriate use of the SME designation. Generally, as a regulatory marker, SME offers a higher degree of consistency and transparency than other potential segmentation methods.

Another concern we have heard is that SME captures participants other than HFT. While surely true, we would again highlight what SME does – that being providing a means to focus on servicing the broad liquidity needs of natural investors (non-SME) while controlling the group of participants where undesirable behavior is coming from now or more likely to come from in the future. We would also refer Staff back to our statements in Question 6 related to the problematic nature of policing behavior whereby the harm being caused can be logically linked to complex environmental incentives and the similar abilities and behaviors of a group of players.

In dialogue with other participants, we have heard concerns that the Aequitas use of the SME designation may create an incentive for participants to find loopholes to facilitate avoidance of the use of the SME tag. RBCDS believes the regulators should take such fraudulent regulatory avoidance extremely seriously. Here, again, there is also an opportunity for IIROC to tighten the SME definition. Further, based upon the insight IIROC is now in a position to glean from the STEP database and the research it is currently conducting on the activities of HFTs, we believe that IIROC will be in a position to ensure that the SME marker is used as intended prior to the planned launch of Aequitas.

Question 9: What, if any, is the impact on market quality and market integrity if market makers are provided matching priority (after broker preferencing)?

We believe this question fails to appropriately explore the integrated intent of the Aequitas eco-system and market making program. The matching priority offered in Dark and Hybrid is clearly offered as a functional benefit for market makers to assist them in position management in fulfillment of their market making obligations in Lit. The proposed structure is intended to promote liquidity leveraging the entire Aequitas eco-system and therefore concessions and obligations should be evaluated as such.

Regarding concerns of “crowding out at the quote” in Hybrid, for natural investors we would point out that in its Lit market Aequitas proposes that non-SME participants (natural investors) enjoy priority in Lit – this includes priority over even Aequitas

market makers. This is in clear recognition of the protected nature of the Lit book. By contrast, in Lit, market makers obligations will be meaningful and aimed at augmenting natural investor liquidity supply – not disenfranchising it.

Based on conversations with other market participants, we agree that some capping or other limitation of market maker priority in Dark and Hybrid would be justifiable to prevent abuse of this priority. This could come in the form of a fixed share cap benefit on priority (potentially linked to a time frequency – e.g. a benefit up to a maximum of X shares per Y minutes), a trade-along participation rate (e.g. market maker receives priority at X per cent participation rate) or other such control mechanisms. Aequitas should be given leeway to responsibly fine-tune market making obligations and benefits in negotiation with market makers and other user groups with the goal of maximizing the ability of the program to achieve measurable improvement in market quality. At the end of the day, we believe appropriately balancing these interests will be critical to the commercial success of Aequitas.

Staff highlights an aspect of the priority mechanism for market makers and how it might be combined with broker preferencing in such a way as to offer a doubling of benefits that could further be multiplied by gaining access to multiple DEA relationships via broker preferencing. Here, attention should be paid to ensure reasonable limitations on the benefits afforded to market makers. This might include limitations on the ability of market makers to enjoy the benefits of market making combined with broker preferencing. In conversations with prospective market makers, Aequitas should seek to identify a reasonable balance early on. Likewise, the score carding process should allow for fine tuning of market maker benefits in an equitable and timely manner. We expect Aequitas will put forth such details as part of a formal application for recognition.

We support regular score carding of the market maker relationship to ensure that benefits accruing to market makers are reasonable in light of their obligations. Assignments should be assessed in aggregate and individually in recognition of the fact that traditional market maker relationships had a mix of more profitable and more challenging assignments. Ultimately, the goal here should be to strike a balance whereby the benefits of market making assignments will net improve market quality for each security under assignment, with particular emphasis on ensuring a value add for more challenging assignments, as well as reasonable but controlled benefit for more attractive assignments.

RBCDS agrees that the Aequitas market making program should be closely monitored to ensure that concerns of investor crowding out are addressed. We would highlight the ability to monitor and manage market quality concerns in dialogue with a single responsible market maker will facilitate the ability to address concerns in a more timely, direct and transparent manner.

From RBCDS's perspective, the proposed Aequitas market making program stands in stark contrast to the incenting of uncommitted liquidity in current lit markets. This status quo is characterized by crowding out of natural investors and any remaining genuine market makers, liquidity fade and the tendency of those with preferred access to use that access to trade ahead of natural investor intent. In light of the poor quality of the liquidity fostered in today's lit books, a market making program

that aims to encourage market makers to act as a backstop on liquidity demand will be a welcome alternative.

Question 10: In light of the details of Aequitas' proposed market maker program, is it reasonable to provide the benefit of priority to a market maker in the Dark and Hybrid books when the market maker's corresponding obligation is limited to the Lit book? If not, should there be market making obligations in Aequitas' Dark or Hybrid books?

We see no reason why rights and obligations for a market maker assignment must reside in the same book. The key goal should be that rights and obligations are appropriately balanced across the Aequitas ecosystem for each security under assignment. The proposed obligation to display liquidity in the Lit book is more appropriate as the obligations can be constructed such that the market maker will be acting as a liquidity provider of last resort – in other words, as a backstop for liquidity demand.

Question 11: Should market making benefits accrue with respect to obligations for market making in non-Aequitas listed securities? If so, why and if not, why not?

RBCDS is of the belief that existing marketplaces have left a significant gap by generically focusing on speed, order-types and variations of maker-taker as the primary means of garnering liquidity. This general trend has served to hollow out traditional market making programs by disenfranchising market makers from more liquid names, while leaving them with responsibilities only in the names that HFTs have shown no interest in.

Having severely under-emphasized the importance of committed market making, Canada now finds itself in the dangerous position of relying almost solely on liquidity provision from multiple (and largely foreign) parties with no commitment and which many argue exhibit damaging collective behaviors. On this basis, Aequitas should be encouraged to explore competitive ways to restore market making of a fashion that does not disenfranchise investors from displaying liquidity, but rather acts to augment liquidity by serving as a backstop.

Question 12: Should DEA clients that are not subject to the direct regulatory authority of the securities regulatory authorities, IIROC and/or the exchange be permitted to act as market makers? Why or why not? How would the following facts affect your response: (i) the DEA client market maker must be sponsored by an IIROC member and (ii) the DEA client market maker must be a member of a self-regulatory organization such as FINRA or otherwise subject to appropriate regulatory oversight?

Clearly the Aequitas proposal relies on the notion that participants can proxy for their clients' responsibilities. In our view, allowing appropriately qualified DEA as market makers acknowledges the reality that most of the firms who have developed the capability to act effectively in a market making capacity reside in the United States.

We would underscore that this is in fact the natural result of a domestic neglect of the importance of committed market making over the past several years in favor of entirely uncommitted posted liquidity based solely on incentives with absolutely no obligations. Given these facts and our view that committed market making is important to orderly markets, we believe that properly qualified DEA clients should be accommodated to act as market makers.

Question 13: Will an un-level playing field be created between DEA client market makers and registered investment dealers that also seek to become market makers on Aequitas' proposed exchange? If so, what are the potential implications in terms of fairness or market integrity?

Staff has expressed concern that foreign non-dealer market makers could have an unfair advantage over Canadian registered investment dealers that seek to become market makers on Aequitas. While we understand the procedural challenge, we would say that focusing on it risks ignoring much bigger and more pressing problems.

In Canada, we have ceded competitive advantage in terms of modern market making capabilities – notably, in stark contrast to the United States. Venue operators in Canada have chosen to emphasize the offering of more incentives to uncommitted HFTs – notably, the bulk of which are DEA clients from The United States. Clearly, RBCDS and many other participants are concerned with the market quality and cost concerns that have arisen as a result of this focus – not to mention the longer-term implications this may have for Canada's equity markets.

Aequitas has proposed reasonable remedies to ensure that DEA client market makers are capable and, through proxy, subject to regulatory oversight. It has also proposed to govern these relationships through contractual agreement. To the extent Canadian dealers compete for market making assignments, efforts should clearly be made to address consistency issues. However, we would argue that ignoring the pressing needs to establish a new sense of shared responsibility for the health of our markets due to procedural and regulatory nuance would be short-sighted and ignore the bigger bottom line issue: Canada urgently needs a plan to foster real modern market making with meaningful obligations.

Question 14: How might Hybrid impact the quality and integrity of the visible market as a whole?

and

Question 15: Please comment on whether the potential benefits of Hybrid for the marketplace participants in Hybrid outweigh any potential risks to the market as a whole? Please identify the relevant benefits and risks.

We believe Aequitas' Hybrid book will have a beneficial impact on the quality and integrity of Canada's visible markets. Should it garner a critical mass of success, we expect a natural result would be for displayed spreads across protected lit markets to moderately widen. We believe this outcome would be both expected and healthy. Why? Because it would be accompanied by a material reduction of intraday volatility consistent with:

- less opportunities for HFTs to engage in active predatory strategies;
- less frenetic competition to pick up signals through order placement then used to cancel and actively compete with investors for liquidity;
- more economically rationale displayed spreads and a closer alignment of displayed and effective spreads for natural investors;
- more confident participation from natural investors founded on lower market access costs and more efficient price discovery.

We would argue that there are several anticipated benefits from the introduction of the Hybrid book. Among them:

- opportunity for price improvement;
- lower costs for natural investors and the networks servicing them;
- a natural competition-driven response to maker-taker pricing which does not rely on regulatory intervention;
- limited transparency resulting in less information leakage.

Of course, it is also possible that Aequitas fails to attract a significant breadth of active or passive liquidity on Hybrid – here we believe the greater risk is that it fails to garner sufficient passive liquidity. This risk is real as it will have to compete within the context of the best quotes on all lit marketplaces – most of which are paying substantial rebates or engaging in de facto segmentation by the use of inverted pricing. This is the commercial risk that Aequitas clearly takes.

While Aequitas may seek to offer a more compelling value proposition for retail networks to route flow, it is our understanding that this would be financed solely out of the economics of Aequitas. Ultimately, we agree that this would make Hybrid a relatively attractive destination to high take venues; however, we would again underscore that it will face competition from inverted venues. As such, we do not agree with the assertions of Staff that this would "result in a higher tendency for the active order flow routed to Hybrid to represent retail client orders."

Being a displayed venue with no natural investor access restrictions (and only a modest proposed difference in take fees), we see no reason why institutional flow would be disinclined to equally pursue any displayed liquidity – even in the presence of a slightly higher (but comparatively low) take fee. In fact, from our perspective, one of the most attractive aspects of the Aequitas proposition is that when combined with its latency normalizing SOR services, all liquidity providers on Hybrid will be unable to segment flow on the fly as has become the practice in today's lit markets. Overall, we see no reason why a modest fee differential for retail would be expected to unduly prejudice the balance of flow on Hybrid to being largely retail.

Staff also raise concerns about the impact on the price discovery process as it relates to Hybrid. In summation, by attracting segmented order flow to Hybrid, Staff has argued that this might somehow impair the price discovery process. Here we disagree based on the following rationale:

- As discussed, we have no reason to believe that the active flow on Hybrid will be anything but broad co-mingled institutional and retail active flow.

- Order flow on other lit markets may become, on balance, more toxic – here we would argue that this will:
    a. disincent posting of irresponsibly narrow quotes in a fashion that obfuscates the real economic spread of the securities in question – this should lead to a moderate (and healthy) widening of spreads;
    b. lessen undue intraday volatility driven by the tendency of HFTs to segment "on the fly" and collectively increase intraday volatility in the process.
- Generally, we would argue that the incentives offered at other marketplaces (maker-taker, co-location, order types, etc.) serve to heavily incent toxic order flow from HFTs. As such, we would suggest that increased toxicity on those marketplaces could be addressed via a response to new competitive realities.
- Unlike in the United States where both payment for order flow and Dark trading has led to rampant compartmentalization of retail flow, the Aequitas model proposes a fair mechanism with transparent and equitable access to natural investor flow.

Question 16: How should the principles of the current regulatory framework and any potential for changes to that framework impact the OSC's consideration of Hybrid? For example, should Hybrid go forward on a pilot basis and be reevaluated based upon some criteria or threshold? What type of criteria or threshold might be appropriate to minimize potential negative impact?

Insofar as these issues are subject to conjecture among various market participants, a pilot might be seen as an attractive option for regulators to gauge the impact of the Aequitas model on market quality. However, we would suggest that in order to be meaningful, the pilot would need to have broad scope (i.e. it would need to apply to all publicly traded symbols) and would need to be of sufficient length to be meaningful. We would suggest that any pilot related to the Aequitas model should be for a minimum time of two and preferably three years from launch.

Question 17: Alternatively, should Hybrid be required to be modified to fit clearly within the established regulatory framework for either visible or dark liquidity? If so, how?

From the perspective of RBCDS, any attempt to force Hybrid to mimic other market models currently in existence in order to fit cleanly in the existing regulatory framework would undermine the fundamental purpose and benefits that Aequitas hopes to bring to Canadian equity markets. We would further argue that such a move would signal a lack of willingness on the part of regulators to foster meaningful competition and innovation to address the concerns that we have heard from many diverse participants. We urge regulators to fully consider the implications that this would have to fostering commercial innovation in the future, and to be mindful of the limitations of regulators to single-handedly resolve complex industry challenges.