A MEMBER OF OMERS WORLDWIDE

OMERS
Capital Markets

Royal Bank Plaza, North Tower
200 Bay St, Suite 2300, PO Box 92
Toronto, ON M5J 2J2

T/ 416-814-4100
F/ 416-362-7773
1-866-576-4880
www.omers.com

A DIVISION OF OMERS ADMINISTRATION CORPORATION

Market Regulation Branch
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Dear Sirs:

RESPONSE TO OSC STAFF NOTICE AND REQUEST FOR COMMENT REGARDING PROPOSED STRUCTURE OF TRADING FACILITIES FOR A NEW EXCHANGE PROPOSED TO BE ESTABLISHED BY AEQUITAS INNOVATIONS INC.

As one of Canada's largest institutional investors, OMERS manages over 60 billion in assets, and is a fiduciary responsible for the savings of over 430,000 plan members. Our vision is to Lead, Perform, Serve and Grow. Our values are to put people FIRST: Fairness, Integrity, Respect, Service and Teamwork.

Over the past five years, the rapid pace of innovation in the Canadian equity market has necessitated an evolution in the regulatory environment. From data consolidation, market access and best execution, to the order protection rule (OPR) and dark trading; the landscape of our capital market is continuously changing. To their credit, regulators set a precedent early on to solicit feedback from all stakeholders before adopting new policy. We commend this approach; when all stakeholders have a voice in the development of our market ecosystem it helps nurture confidence and promotes a fair and efficient capital market.

OMERS believes the widespread adoption of algorithmic trading, generally, has increased the efficiency of our marketplace. High frequency trading (HFT), while difficult to define, is a subset of the broader genre of algorithmic trading. Therefore, our concern is less directed towards HFT per se, than it is with the asymmetric playing field of our microstructure, the use of certain predatory order detection practices, and the unnecessarily high level of gaming in the marketplace.

The existing market micro-structure built around maker/taker pricing models, speed, and technology, implicitly favours the needs of incumbent exchanges and marketplace intermediaries over the needs of end users – issuers and investors. The Aequitas proposal is an innovative market based solution that challenges the rules, but promotes the five principles highlighted by the CSA and IIROC as relevant to assessing market structure changes: price discovery, market liquidity, transparency, fairness, and integrity.

Our responses to the OSC's questions are provided below. Should you have any further inquiries, please do not hesitate in contacting me directly.

Yours truly,

Brent Robertson
Director, Trading, Beta Portfolio Management

Royal Bank Plaza, North Tower
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Toronto, ON M5J 2J2

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Segmentation of order flow in the context of the principles underlying OPR

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?

The Order Protection Rule (OPR) should be enforced on protected quotes in protected marketplaces; however, the order protection rule does not have to apply to all market venues and should not preclude sophisticated institutional participants (accredited investors) from executing transactions outside of the NBBO on an unprotected marketplace as long as it is consistent with best execution.

The strict application of the OPR itself may conflict with a fiduciary's responsibility to provide best execution. When a marketplace is displaying sufficient liquidity, best execution simplifies to best price. However, best execution is more than simply best price when the desired size exceeds the quantity of liquidity immediately displayed at the BBO on a given venue. For example, the risk associated with a poor quality fill could lead to an adverse tick or fading size. This risk may trump the potential benefit of a marginally superior price, with a smaller size fill and a need to re-engage the market. The order protection rule essentially forces investors to prioritize price in their routing decisions, as opposed to a more holistic approach weighing all relevant execution costs and risks (probability of receiving a fill, information leakage, fees, type of counterparty etc.). The order protection may be inconsistent with this more holistic approach to analyzing trading costs, best execution and routing behavior.

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?

It is our understanding that Aequitas intends to apply for an OPR exemption for Hybrid. Not-with-standing the above, we also believe the OPR can apply to Hybrid as trades on Hybrid will not be able to occur at a price that is worse than the price available on any other protected market.

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?

If Hybrid is treated similarly to a dark pool, as an unprotected marketplace, than the NBBO (ex-Hybrid) will be used as a reference price

When Hybrid is displaying quotes superior to ex-Hybrid NBBO, this should enhance transparency and facilitate price discovery by decreasing the incentive to execute dark orders and encouraging the shift of liquidity toward the Aequitas lit and grey books.

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?

With the assumption that Aequitas asks for exemption from the OPR, the NBBO will not include the Hybrid best bid and/or Hybrid best offer.

Segmentation of order flow in the context of the principles underlying fair access

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

We are fully supportive of the fair access requirements. In our view the principles behind fair access include both reasonableness and judgement. Is it reasonable that some forms of restrictions still allow for fair access for natural order flow to occur? Yes. Can we judge a marketplace that uses restrictions that are well presented and known for providing fair access to market participants? Yes.

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?

From a buy-side perspective, with restrictions on access to certain market participants, there would be a benefit to allowing natural trade flow interactions to develop. For the long-term investor all liquidity is not of equal quality. We see increasing evidence of this phenomenon in the other markets where it is common practice to alter the size of an order, and to make routing decisions, based on the perceived quality of the liquidity. Similarly, in the Canadian marketplace, long-term investors would benefit from the flexibility to adjust the type of liquidity with which they interact.

Reasonable levels of segmentation would break down order flow into homogenous units based on the investor’s underlying preferences (e.g. risk/return, time horizon, level of sophistication etc.). Ad hoc discrimination of orders based on client identifiers or algo-strategy (e.g. VWAP order flow) should not be permitted. We acknowledge that differentiating between a reasonable level of segmentation that is welfare enhancing, while limiting discriminatory practices that are welfare destructive, will likely prove quite challenging. Pilot programs can be used to study the impact of any unintended consequences, while still maintaining an environment supportive of innovation and competition.

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

The segmentation of order flow on Hybrid is necessary to create a safe environment that encourages the posting of larger limit orders. It is our belief that fair access does not require equal access to liquidity. Initially, fair access rules were necessary to ensure compliance with the order protection rule, which itself, was put in place to foster confidence and display liquidity in a fragmenting market. However, it is not clear that all marketplaces should be subject to order protection. Sophisticated institutional investors may choose to give up the right to order protection, for the benefit of interacting with segmented flow.

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

Yes it is. Provided there is proper enforcement of the SME marker.

Market maker priority

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

Priority matching in the Aequitas Dark and Hybrid books is intended to provide compensation for what could otherwise be uneconomic market-making obligations. Increasing the quality of Canada's market making regime will enhance price discovery and broaden quotes, benefiting all investors.

Since the benefits of proper market making will accrue to all investors, market making itself can be viewed as a type of public good. Market makers ought to be incentivized to provide liquidity where and when it is needed, and not merely to act as informed traders profiting from millisecond information asymmetries in the market. Therefore, in order to provide a sufficient incentive to make quality markets, but still limit the potential for predatory behavior and monopolistic profits, Aequitas should consider providing a regulated level of compensation to its market makers. This compensation could be in the form of matching priority or in the participation in matched trades.

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?

It is reasonable to provide the benefit of priority to a market maker. The marketplace has evolved into a complex ecosystem where fragmented liquidity and reference pricing creates a dependency across venues. Therefore, the benefits and obligations of a market maker ought to be evaluated across the entire Aequitas ecosystem and not in isolation to any specific order book.

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?

Any benefits provided to a market maker ought to apply only to the relevant securities of jurisdiction and not to all listings on Aequitas.

DEA clients as market makers

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?

At a minimum the DEA client market maker must be subject to appropriate regulatory oversight. Under the gatekeeper obligations of Third-party Electronic Access, a foreign DEA client market maker would be subject to the oversight of the sponsoring dealer, while a higher standard of oversight ought to be established directly between the exchange and the DEA client market maker.

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?

DEA client market makers have the added benefit of broker preferencing relative to registered investment dealers. It is our understanding that Aequitas envisions having only one market maker per security. DEA clients and investment dealers will not be competing to make markets in the same securities.

Potential impact of Hybrid on market quality and market integrity

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

While the users of Hybrid will likely be sophisticated institutional investors, the prospective benefits of enhanced price discovery, and reliable market making will benefit all investors, including retail investors.

A fragmented market structure requires the opportunistic routing and re-routing of orders in search of liquidity. Fragmentation and routing encourage electronic order shredding, queue jumping, smaller trade size, and a recurring need to re-engage the market. The existing micro-structure encourages an unnecessarily high level of trade intermediation in the marketplace, inflating volumes, and exacerbating information leakage, as liquidity is passed from one intermediary to another. This additional complexity increases data costs for all users and results in the suboptimal utilization of resources – specifically, the over investment in speed and technology. By encouraging the safe posting of larger limit orders, Hybrid will facilitate the interaction of natural buyers and sellers, reducing the need for short-term intermediation, and improving the quality of our market.

If Hybrid is successful, spreads may widen to include the hidden cost of maker/taker rebates. Volumes could decline as the natural interaction of long-term investors reduces the need for intermediation. Quotes would likely become more stable, and message traffic should decline as Hybrid accumulates the interest of long-term investors who, at the margin, favour size over price, and the use of displayed limit orders.

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.

From a buy-side perspective, the potential benefits outweigh the risks.

1) Recognizing that all liquidity is not homogenous is a potential benefit of Hybrid. Allowing users the ability to differentiate order flow may allow them to better comply with their best execution requirements.
2) Hybrid's unique weighted size/time mechanism will provide incentive for the displaying of larger limit orders, increasing the breadth of liquidity around the quote.
3) The current level of fragmentation in the marketplace is structurally inefficient and ultimately unsustainable. If successful, the Aequitas model should be a consolidating force over the long term.
4) If Hybrid can attract a critical mass of liquidity, its flat fee structure, should put pressure on the maker/taker model, increasing the transparency of spreads to reflect the true economic cost of liquidity.

Potential risks of Hybrid are increased complexity and fragmentation over the short term and the law of unintended consequences. However, we believe the use of a pilot program would mitigate these concerns.

<u>**Hybrid as a visible market**</u>

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?

The proposal by Aequitas is sufficiently different from what exists in today's marketplace that the rules by which the proposal is judged should be reviewed. In times of rapid innovation a principles-based approach to regulation often becomes a more pragmatic solution than a rules-based approach. Principles that focus on net benefits to long-term institutional investors and the retail investors should be considered. If a pilot program is established there should be requirements for clear guidelines, rules, and a time frame to properly evaluate the impact of Aequitas on the Canadian marketplace.

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?

No. The Aequitas proposal is an innovative solution that attempts to restore balance to the marketplace.