

October 4, 2013

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

Dear Sirs/Mesdames:

**Re: Notice and Request for Comment regarding Proposed Structure of
Trading Facilities for a New Exchange Proposed to be Established by
Aequitas Innovations Inc.**

Introduction

Thank you for the opportunity to provide comment on the issues raised in the August 13, 2013 OSC Notice and Request for Comment (the "Notice") concerning the new equities exchange proposed by Aequitas Innovations Inc. ("Aequitas") and, in particular, certain innovative proposals relating to its proposed trading structure (the "Aequitas Proposal").

Wildeboer Dellelce LLP is a law firm formed in 1993 which delivers business law services with a particular emphasis on small and emerging public companies -- as counsel to those companies, as counsel to investment dealers who finance those companies as well as counsel to institutional and other investors who wish to invest in them. Stock exchanges play a critical role in efficiently and effectively moving capital from savers to users of capital. As a result, we have a keen interest in any proposal to establish a new stock exchange. We have enjoyed working with teams of professionals active in designing and operating trading platforms and exchanges in Canada. In particular, we provided advice to Alpha Trading Systems until its acquisition by the Maple Group and more recently have provided certain services to Aequitas as it takes steps to be recognized as a new equities exchange in Canada.

OSC Staff appears to be taking a principles-based approach to the review of proposals for the formation of stock exchanges, such as that of Aequitas, and for the formation of alternative trading systems, to examine whether their proposals will or are likely to improve the quality of the Canadian trading markets. It is essential that such proposals meaningfully contribute to competition and exhibit novel features which improve market quality because each such proposal brings with it the risk of additional market fragmentation, as was noted in the response to the recent Omega/Lynx ATS application.

We believe that the Aequitas Proposal, particularly the creation of a Hybrid book, is innovative in two respects. First, it suggests a path forward which seeks to balance the benefits of high frequency trading ("HFT") participation in the marketplace with the desire to curb what are perceived to be the most unfair or improper market behaviours impacting upon retail and institutional confidence and participation in the marketplace. Second, it contemplates a novel



method to compensate market makers in a manner that reinforces the need for such market making services during periods of market disruption. While we recognize that there is a view that HFT participants can contribute liquidity and other benefits to the marketplace, at the same time most observers would agree that HFT participants raise serious concerns with respect to the integrity of the markets. If it is true that some participants have developed and/or use methods that permit them to “game” the market by manipulating the rules and processes by which the markets operate in order to make a profit without regard to the original purpose of the marketplace (i.e. to put users of capital together with investors) then we believe the OSC Staff should carefully consider proposals such as that of Aequitas whose stated purpose is to bring the current operation of the marketplace back in line with its purposes.

Segmentation of order flow

In our view, one of the most significant effects of the Aequitas Proposal on the current regulatory regime is that it is not fully compliant with order protection requirements (“OPR”) since active orders marked as short marking exempt (“SME”), as a proxy for HFT order flow, would be rejected. This would appear on its face to be a reasonable by-product of policies designed to address certain adverse market behaviours associated with HFT order flow in an effort to improve market quality. The question is whether this method of identifying, and segmenting, orders is an appropriate way to identify those orders that are determined to be not conducive to the price discovery process. Our view is that this question can reasonably be answered by reviewing the circumstances surrounding such trades – Aequitas and other observers believe that using the SME tag is an appropriate way to discern such order and we see no reason to doubt this view. OPR was implemented to, among other things, foster an incentive to contribute to the price discovery process by assuring investors that better-priced orders would be filled ahead of inferior-priced orders. Without that protection, the assumption is that investor confidence may be diminished and investors may exit the market and thereby reduce liquidity. However, many market participants (including certain of our clients) believe that HFTs detract from market quality and do not contribute to necessary liquidity at the time when the markets require it the most. Consequently, we do not believe that a trading platform that segments HFT order flow would necessarily result in reduced confidence or liquidity in the marketplace, provided that it reasonably captures or limits access to the targeted order flow.

In our view, the fair access issue discussed at pages 13 and 14 of the Notice is not nearly as significant. The Aequitas Proposal clearly describes the circumstances in which an active order would be rejected. It does not preclude any other form of trading undertaken by HFTs and indeed Staff notes that it is its expectation that due to the dynamics of the Hybrid Book, it is expected that the majority of orders on the Hybrid book will constitute passive HFT orders. This would appear to be a reasonable limitation on access to avoid predatory practices and to encourage retail and institutional investors to participate in the Hybrid book.

Aequitas market making program

Our view is that this is the second manner in which the Aequitas Proposal is innovative. Just as the “maker-taker” fee model was an innovation in liquidity incentives, the Proposal suggests a methodology to incentivise market makers which is designed to result in real liquidity during periods of market disruption. The “maker-taker” model provides rebates to liquidity makers through their intermediation and therefore would appear to have certain negative consequences in volatile markets. Of greatest concern is the “crowding out” in most markets of “true” market makers in favour of HFTs whose market making activity evaporates in less accommodating markets. A model that encourages better price discovery in all markets should be favoured. That said, it is important that Aequitas ensure that the obligations of market makers are

proportionate to the execution priority benefit, and that the benefits realized by acting as a market maker in the Aequitas model are commensurate with the obligations that are incurred.

It would seem to be appropriate that market makers that are not subject to OSC or IIROC regulation should in every case be regulated by an equivalent securities regulatory agency such as the SEC or FINRA. In the past the OSC has in several areas recognized that separate Canadian regulation of non-resident entities acts as a bar to their participation in the Canadian marketplace. The significant benefit of enlarging the pool of potential market makers (which may include HFTs) suggests that in these circumstances it is appropriate to rely upon the significant oversight of foreign regulatory agencies (in particular, US regulatory agencies) and the protocols that the OSC has in place with those agencies. In our view, no competitive advantage would accrue to such HFTs as the regulatory environment with which they comply in the United States, for example, is no less onerous than that in Canada.

Conclusion

The Notice succinctly re-states the public interest objectives in regulating domestic exchanges and alternative trading systems. Achieving these objectives when regulating the secondary markets is particularly challenging given the speed of change and the global nature of trading in equity securities, fixed income securities and derivatives. The prudent and measured approach to regulation in this area has been to assess whether a proposal is unique and addresses in its provisions a method to foster fair and efficient markets by addressing both real and perceived market abuses. If the OSC believes that a proposal advances or is likely to advance those objectives in the marketplace then some form of pilot program whereby the system is tested would seem to be the most prudent course of action. During such a period, the Aequitas Proposal could be assessed against both its perceived benefits (to confirm that the alleged abuses in fact are ameliorated) and to determine if other more harmful consequences to the Proposal become evident. If the OSC is convinced that the Aequitas Proposal has merit and helps to achieve OSC policy objectives then it is incumbent on it to place reasonable limits on OPR and fair access to obtain these benefits.

If at any time you wish to discuss any of the above please do not hesitate to contact Ronald Schwass (rschwass@wildlaw.ca or 416-361-4789), Al Wiens (awiens@wildlaw.ca or 416-361-4791) or Geoff Cher (gcher@wildlaw.ca or 416-361-4793).

Yours truly,

“Wildeboer Dellelce LLP”