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Market Regulation Branch
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
marketregulation@osc.gov.on.ca

and

Katrina Prokopy
Chief Legal Officer and Head of Regulatory Affairs
Coinsquare Capital Markets Ltd.
590 King Street West, Suite 400
Toronto, ON, M5V 1M3
katrina.prokopy@coinsquare.com

Via Email

Re: Coinsquare ATS – Notice of Initial Operations and Request for Comments

Scotiabank appreciates the opportunity to comment on the proposal by Coinsquare Capital Markets Ltd (“CCML”) to launch and operate Coinsquare ATS, a marketplace for digital assets (the “Proposal”).

General Remarks

We acknowledge that CCML is proposing to introduce an ATS in an asset class which is currently not traded under traditional Canadian marketplace rules. The proposal is novel in many respects. We are supportive of innovation in the Canadian market and believe that introducing trading facilities for digital assets within the existing rules framework may improve the integrity of the digital asset market. Given the novelty of the Proposal, we believe that sufficient information should be provided for the community to be able to adequately assess and comment on potential areas of broader impact. This is doubly important given the precedent-setting nature of the Proposal, as it deals with an asset class not currently supported by any existing ATS.

We believe that the Proposal currently falls short of the disclosure detail bar overall, and would request that the Proposal be amended, expanded and republished for additional comments prior to any possible approval.

We will highlight certain specific areas of concern which we believe require clarification or further discussion.

Settlement

We agree with the requirement that clients of Coinsquare's dealer business unit be required to prefund. We take this requirement as to mean direct clients of the Coinsquare dealer, which maintain accounts at Coinsquare and where Coinsquare may hold digital assets on their behalf. However, as written the Proposal does not suggest that dealer members wishing to access Coinsquare ATS, rather than the Coinsquare dealer, will be required to also maintain client accounts at the Coinsquare dealer. If that requirement were in place, it would represent in our view an unusual requirement to engage in dealer services connected to access to the Coinsquare ATS, at odds with established practices of existing Canadian ATSs also operated by dealer members (for example, Instinet Canada Cross). We note that no economic terms for such a relationship are disclosed; the Coinsquare dealer would be in a position to dictate the cost of access, with these costs not generally being subject to regulatory oversight. We view this as an area of concern and potential conflict of interest.

The section of the Proposal dealing with settlements indicates that Coinsquare will notify Subscribers, on a bilateral ("Subscriber-to-Subscriber") basis of their respective net settlement obligation, at which time Subscribers will be required to settle with each other and confirm final settlement with the ATS.

This raises several concerns:

- Since any Subscriber can trade with any other Subscriber on the ATS, all Subscribers will potentially need to be able to settle with all other Subscribers. This requires business relationships to exist between dealers. Any new dealers seeking to become Subscribers must be full members of the collection of Subscribers, introducing a significant barrier to entry. Further, this de-facto requirement gives each Subscriber a veto over the entry of another dealer into the network. This is because any Subscriber could simply refuse to open credit with another – meaning that if a trade were to happen between them (in a multilateral market), that trade would not be settled bilaterally.
- As settlement is bilateral, and requires credit relationships to exist, dealers must be free to negotiate policies for how they face each other as Coinsquare ATS Subscribers. Those terms may differ from firm to firm, and may be at odds with Coinsquare ATS's wishes – or the fair & orderly operation of the multilateral Coinsquare ATS market.
- There is no clarity on the manner of settlement (i.e. use of wire transfers, escrow agents, etc.), timing requirements, or what recourse there may be for bilateral settlement fails. For instance, it is not clear what remedy would be available if a Subscriber issues payment in fiat, and is owed the corresponding Digital Asset for an extended amount of time. It is also unclear

what safeguards exist to manage the risk that Digital Asset transfers are erroneously sent to the wrong wallet.

In the traditional finance ecosystem, such bilateral arrangements are commonplace for over-the-counter instruments, supported by ISDA agreements governing bilateral terms. However, Coinsquare ATS is being proposed as a multilateral marketplace open to IIROC dealer members – and not a centralized market for bilateral trading of standardized derivative contracts.

Further, the bilateral nature of settlement as described introduces the potential for cascading credit risk between counterparties. If settlement is bilateral, as described in the Proposal, Subscribers must be in a position to control credit limits with each other – on a trade-by-trade basis. For example, Subscribers must be able to avoid situations where their trades with multiple different firms result in a cascade of fails because a single counterparty has failed to deliver. This is particularly important given that settlement (as described) would be through separate independent legs of fiat and digital assets transfers, whereby payment for the digital asset would be made first – to a counterparty that may then not deliver the digital asset as contracted until a later time (if ever).

Other ATSs operating in Ontario all benefit from the existence of central clearing facilities. Coinsquare ATS cannot claim this benefit, as no central clearing for digital assets exists.

In short, we believe the Coinsquare ATS proposal should be amended to clarify the settlement mechanics. Without an adequate settlement protocol which manages counterparty and systemic risks, we do not believe a multilateral ATS can be approved at this time.

Fair Access

All marketplaces operating in Ontario are required to provide fair access to their services, meaning that they may not unreasonably condition or restrict access to the facility. We believe the Proposal, as written, introduces a number of fair access concerns.

First, the settlement issues above introduce either a requirement that all Subscribers establish credit relationships with each other (which is difficult), or potentially become trading clients of Coinsquare Capital Markets Ltd. The former would effectively grant a veto to any Subscriber (include Coinsquare itself), as they could refuse to enter into a credit relationship with a new counterparty. The latter would effectively make Coinsquare ATS a single-dealer platform, since all Subscribers of the ATS are effectively clients of Coinsquare itself – rather than dealers operating independently.

Second, while the requirement that all Coinsquare ATS members must be IIROC members is reasonable, it bears noting that IIROC would have to approve each dealer's activities in digital assets. There are currently no written or proposed rules on this topic from IIROC. It is impossible to judge whether this standard is an unreasonable condition of access for most dealers.

Third, all dealers must have the ability to hold digital assets. While this is ordinarily a reasonable requirement, as of this writing only one dealer in Canada has any capability to hold digital assets. It is therefore impossible to judge whether this requirement would unreasonably condition or restrict access to Coinsquare ATS.

Other Matters

Coinsquare's two separate businesses – that of a dealer and an ATS – are being presented as operated separately, but as a single entity. No details are provided on how conflicts of interest, real or perceived, will be managed. We do not believe it is sufficient for the broader marketplace to rely on the representation that *“Coinsquare has policies and procedures in place to appropriately manage any conflicts between its OEO dealer activities, the Coinsquare ATS, and other Coinsquare businesses.”*

Coinsquare represents that market surveillance will be conducted by Coinsquare ATSS, with IIROC oversight. We believe that at this time UMIR does not sufficiently address trading of digital assets, and therefore Coinsquare ATS would need to establish (including through publication for comment) market integrity rules under which surveillance will be conducted. Alternatively, UMIR must be amended prior to the operation of Coinsquare ATS to incorporate specific provisions unique to the crypto ecosystem and which may represent risks unique to crypto assets. This effort would be akin to recent work done by IIROC to introduce derivative products into the scope of UMIR, an initiative with a more manageable scope and fewer unknowns than an outright expansion of UMIR to cover crypto asset trading.

Further, the Proposal indicates that Coinsquare ATS will self-police until IIROC is able to provide surveillance services. We are concerned that this is a window of unknown length, and potentially very long. As market integrity is of utmost concern to the Canadian ecosystem, we believe a concrete plan for surveillance must be in place – and available for public comment – prior to approval and go-live.

The Proposal also does not address how potential conflicts of interests between the surveillance function (interim or otherwise) and the broader for-profit business will be managed. We believe it is critical for the surveillance of market activity, and the maintenance of market integrity, be decoupled from and independent of any commercial motives in the entity. The Proposal indicates that policies & procedures exist to manage conflicts between OEO dealer & ATS activities, but no details are provided, including whether these policies specifically address potential conflicts between trading and surveillance. We believe this is particularly important to clarify given Coinsquare's past issues in this area.

Finally, Coinsquare ATS fees are not yet disclosed at www.coinsquare.com, as indicated in the Proposal. In fact, no mention of Coinsquare ATS appears to be found on the website at all. It is

The Bank of Nova Scotia
Global Equity
Scotia Plaza
40 King Street West, 68th Floor
Toronto, ON M5H 1H1



therefore impossible to judge whether the fees “unreasonably condition or limit access to Coinsquare ATS’ services” as indicated in the text of the Proposal.

Conclusion

Our overall view of the Proposal is that the Coinsquare ATS is being structured as a single-dealer platform – with the only firm functionally able to access the marketplace is Coinsquare’s dealer business itself. This structure is fundamentally at odds with the principles of fair access.

The Coinsquare ATS is novel and unique. If approved, it would introduce Canada’s first digital assets ATS, and serve as a template to others seeking to enter the market. The precedent that would be set through approval could introduce the risk of entrenching practices that ultimately lead to systemic risk or unintended side-effects – particularly related to potential settlement risks among major counterparties.

Given the above, we believe that the Proposal should not be approved as presented at this time. Once the specific issues of IIROC dealer membership (as a condition of access) and associated settlement mechanics are clarified, it would be appropriate to republish an amended Proposal for further comment by industry.

We appreciate the opportunity to comment on this matter.

Respectfully,

Alex Perel, CFA
Head of ETF Services
Scotiabank Global Banking and Markets
(416) 862-3158
alex.perel@scotiabank.com