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Via email

Dear Sirs:

Re: CSA Staff Consultation Paper 21-401 – Real-Time Market Data Fees

TD Securities welcomes the opportunity to provide feedback on CSA Staff Consultation Paper 21-401 – Real-Time Market Data Fees.

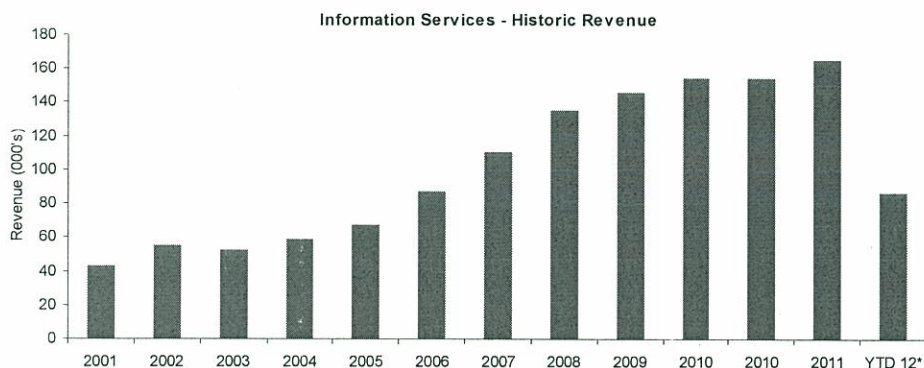
TD Securities Inc. (TDSI) is a leading securities dealer in Canada and is the number one equity block trader in Canada based on dollar value and shares traded. TD Securities also acts as the executing dealer for TD Waterhouse which is the largest discount brokerage firm in Canada.

Background

Since demutualization of the TSX in 2002, there has been a growing tension between the interests of shareholders of the TSX and stakeholders in the market in Canada. This tension arises because certain of the TSX's businesses are not subject to the forces of competition, one being the sale of market data. In a competitive industry, the forces of competition suggest that as competition rises, prices decline until economic profits approach zero. However, given the fact that the purchase of real time market data is required for brokers to manage best price and best execution obligations, demand for market data from marketplaces such as the TSX is not elastic. In addition to the straight sale of market data, marketplaces earn revenue from sale of proprietary data feeds that are tailored to specific user needs pertaining primarily to speed, which ultimately forces other participants to subscribe for these feeds in order to keep a level playing field. In the 10 years since the TSX demutualized, revenue from market data increased from approximately \$45 million in 2001 to over \$160 million in 2011. Further, in the five years since marketplace competition arrived in Canada, a period in which the TSX's market share declined from close to 100% to approximately 65% (ex Alpha), TMX revenue from market data rose by about 45% (to the end of 2011).



TSX Market Data Revenue



Source: TSX

While it is very difficult to try to normalize changes in market data fees over time in order to determine the per user price change, suffice it to say that the average consumer of TSX market data has not seen a fee decrease during the period since marketplace competition arrived. To make matters worse, these same consumers of market data are required to purchase real time data from the other new marketplaces that have been launched in the past 5 years. To the frustration of market participants, these new markets were able to charge for market data without first proving any contribution to price discovery in Canada.

In fact, we are led to believe that market data revenue has helped to subsidize a few fledgling marketplaces trying to compete for a share of Canadian trading. After all, one has to ask how a marketplace can last for several years with less than two or three percent market share in Canada, without ancillary revenue such as market data. To the chagrin of market participants, not only are some of these small markets surviving, they are launching second platforms. In the end, not only has the average consumer of market data not seen a decrease in TSX data fees at least commensurate with its reduction in share of trading, in fact, the overall cost of acquiring the necessary market data has as much as doubled since the arrival of marketplace competition. Increased competition is not supposed to equal increased fees as it has in Canadian equity trading. Clearly, this was not the result that the architects of Regulation ATS envisioned when approving the rule structure in 1997 paving the way for trading competition in Canada.

Market data is a public good which is ultimately produced by the participants of a market. The added value of a marketplace is in the aggregation and distribution of this data, and we consider it fair to compensate marketplaces for this function. However, as new marketplaces have been created, the burden of aggregating and distributing data has fallen on the users who now need to subscribe to an increasing number of market data feeds and consolidate the data on their own end. The value that marketplaces add in aggregation has fallen at the same time that market data costs have escalated, as users have increased their payments to marketplaces while taking on the aggregation function that used to be provided by marketplaces. Compensating marketplaces for market data on a cost-recovery basis only entrenches the problem and provides no incentive for creating a more efficient market data distribution model. This has led to the exceptionally inefficient and economically wasteful market data structure that we see in the Canadian market today.

With that background in mind, we are extremely pleased that Canadian regulators decided to tackle this complex topic. Clearly, market data is a valued asset and, as such, has worth to marketplaces and market participants. However, the ability for marketplaces to charge for market



data without a proper framework or minimum standards for contribution to price discovery has been a hole in Canada's regulatory landscape until now.

General Comments on the CSA Paper

We agree with the general conclusion reached by the CSA consultation paper that steps should be taken to address real time market data fees. However, we do not agree with a few of the more specific points made in the report. First, the report states that "TSX and TSXV market data fees do not appear unreasonable in relation to their share of trading activity." Secondly, the report concludes that the cost of consolidated data is higher in Canada than the US but that may be due to structural factors. Thirdly, the report notes that marketplaces with a smaller market share are charging data fees that are high in relation to market share, but that these higher fees per share of volume may be due to infrastructure costs that are not able to be amortized over a larger base of business. We disagree with the above and will discuss later in this submission.

The problem with any quantitative market structure analysis is that all conclusions are subject to questions about methodology used. In this case, we think that comparing data costs in Canada based solely on an analysis of volume traded is distorted. Volume is only one element of price discovery – for instance, what if a market's volume is primarily driven by block crosses that are derivative related or printed by the upstairs market? Further, quantitative comparisons with the US and Europe are flawed due to significant differences in market structure. As such, we hope that the CSA will listen carefully to qualitative feedback from users when the response letters are completed.

For instance, the report scales fees in Canada relative to volume traded. However, several marketplaces in Canada have volume distorted by factors specific to each marketplace. (For instance, Pure's market share of 3.6% consists almost entirely of pre market event driven volume and block crosses). As well, Alpha's percentage of trade comes from active retail flow that preferences Alpha and is portable. There is clearly no perfect manner to determine each market's contribution to price discovery. We believe a simple volume analysis is clearly flawed or at least subject to limits in relevance. At the very least it would make sense to look at a market's depth of order book as well as the percentage of time a market sets the National Best Bid and Offer (NBBO) for all stocks.

In the case of the comparison with the US, the report concludes that on a per million shares of volume traded, Canadian data costs are approximately 10 times higher than the US. This fee difference may be justified by the fact that US trading volume is 7 times higher than Canada and that the greater size of the US market allows for economies of scale. However, the cost of producing market data is not linear. To say that because the US market is significantly bigger by multiples in some way justifies higher fees on a relative basis in Canada is simply not accurate.

Separately, it is very difficult to make fair per volume traded comparisons with Europe as there is no Order Protection Rule in the European markets, meaning traders are not captive to markets in the same way, and share prices are significantly different than averages in Canada.

Finally, the fact that smaller markets are charging more relative to larger markets, and that these higher relative fees are justified by the fact that infrastructure costs cannot be amortized over a larger scale of business, just does not hold water with our firm. Why should a marketplace that struggles to survive on its trading volume alone be able to make up for lack of trading revenue by charging exorbitant market data fees to a captive client base? After all, if a marketplace has low volume of trade, then this likely means its contribution to price discovery is low? Unfortunately, Canada's market structure rules require participants to connect to new marketplaces immediately



in order to ensure compliance with order protection rules. We would like to see some form of minimum standards required prior to this obligation kicking in, especially now that there are several competing trading venues in existence.

The CSA's report offers eight different possible solutions for regulating market data. We are not in favour of pursuing any of these specific options. Our thoughts on each of these alternatives are as follows:

Option 1) **Cap Fees for "Core Data"** – this leads to question of what defines core data and might lead to further bifurcation of haves and have nots if core data is sold without important data elements;

Option 2) **Cap Data fees charged by a marketplace until it meets a de minimis threshold** – we prefer that regulators impose an immediate moratorium on new marketplaces, unless a new market can demonstrate unique features that will contribute to price discovery without undue cost on participants. However, a capping of fees for new marketplaces or those that do not meet a reasonable de minimis standard is a good start;

Option 3) **Cap all Data fees for all marketplaces starting at a de minimis threshold and gradually increasing the threshold and the applicable caps** – this option seems complicated and subject to abuses – for instance, what if a marketplace were to achieve the minimum threshold by simply executing block crosses? Further, see comments applicable to option 2;

Option 4) **Cap fees for data sold through the information processor (IP)** – we believe this suggestion is aimed at encouraging use of the Information Processor for the purchase of data. However, in a perverse way, we worry about this model resulting in marketplaces discounting data through direct subscription, meaning that the IP's fees may end up higher than direct subscriptions. Unfortunately, the participants that receive data directly from marketplaces tend to be more sophisticated and thus this model would not likely benefit end investors. In our opinion, any cap needs to apply regardless of where the data is purchased.

Option 5) **Regulate consolidated market data fees charged by the IP** – this is essentially the model used in the United States since the 1970s. The US information processor is the NYSE for its own listings (note: the NYSE was fined recently by the SEC for providing its own trading data faster through direct feed than through the IP). One concern we have is that this group will, like some people feel is the case in the US, keep overall fees higher than perhaps is warranted, but this fear may be manageable with the proper oversight model. Note: while some US marketplaces will trumpet the fact that Level 1 market data fees have not increased in decades in the US, the flipside is that these fees have also NOT come down, despite the fact that the cost of producing and distributing this data is likely much lower today than 20 years ago. Further, it is very difficult to understand the formula used to determine data fees in the US – marketplaces that contribute quotes and trading information to the IP receive a portion of data fees based on percentage of overall contribution to price discovery. To create a model that works in Canada and is fair may be quite difficult;

Option 6) **Cap consolidated data fees sold by marketplaces to all data vendors, not just to the IP** – This option is better than option 4 but not the best option overall. The US model shows that capping fees does not necessarily lead to the best end result for users as the cap only affects the cost of receiving the data, and does not consider the cost of producing this data;

Option 7) **Mandate a data utility to operate on a cost recovery basis** - While it may be difficult to create a cost recovery structure, it appears to be the best option of the eight alternatives, as long



as there is an emphasis on maintaining competitive technology. Creating a common market data service would remove the burden on users to aggregate data and would level the playing field if it were mandated as the sole provider for Canadian market data. The difficulty will be in properly determining the costs allocated to this venture, as it would be unlikely that the data utility manager would run this business using stand alone infrastructure.

Option 8) **Publish amendments to market data fees and fee models for comments** – the idea that a marketplace needs to publish fee changes for comment is one we support wholeheartedly. In fact, this rule should be applied as well to marketplace trading fee changes (or any changes that affect the cost of accessing quotes). After all, market participants are captive customers of marketplaces and should be given a right to comment on matters that affect the costs of participation in the market. That said, we prefer a system of regulatory oversight for market data over the time consuming process of commenting on each and every proposed fee change.

Our Recommendation

Instead of utilizing a straight cost recovery model, we believe a better approach is to allow an industry vendor such as the TSX to be given a rate of return target for managing the distribution of market data and accompanying revenues. This rate of return target would contain performance/efficiency hurdles that allow for outperformance if efficiencies are achieved (similar to the manner with which pipelines are regulated). This vendor would be mandated as the sole provider of Canadian market data to prevent a bifurcation between the common and marketplace-specific feeds, with marketplaces sharing revenue based on contribution to price discovery.

Of course, there remains the formula with which data revenues are distributed, and this would require a Board (or Oversight Committee) to be formed in order to ensure fairness to the model and also to be able to adjust the model based on changes to market structure over time. Importantly, to avoid the risk of collusion amongst the parties contributing to the data utility, we recommend that an independent Chair be appointed to this oversight committee, and that an equal number of independent (i.e., not affiliated with a marketplace) members be included on the committee.

Finally, we believe that new marketplaces should NOT be allowed to collect market data revenues until “de minimis” thresholds are met (to be established by the Oversight Committee) and that marketplaces that fall below these minimum thresholds lose the right to participate in the market data revenue allocation.

The bottom line is that it appears the only way to stop the cost of market data from rising further is through regulatory intervention. As such, we commend the CSA for taking this important first step in addressing the issue of spiralling data costs. The market is a finite system. If 10 new markets come into Canada and take a 20% share of trading from the incumbents, and then start charging for data fees that are commensurate to market share, the end result is higher fees for captive market participants. Yet, the pie of trading has not really changed (even if volumes increase once these new markets arrive). Most likely, volume of trade has simply been redistributed amongst the new markets, which in no way justifies higher data fees to end users.

Answers to Specific Questions

Option 1) Cap Fees for “Core Data”



Question 1: Are there unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

We do not support the concept of a cap on fees for core data. The definition of core data will be difficult to establish, amongst other problems with this concept. Further, by limiting the specific elements of data sent as part of core package, this may lead to opportunities for sophisticated users to take advantage of more expensive and comprehensive data feeds which disadvantages regular participants in the marketplace that are consuming data for the purposes of long term investment decisions.

Question 2: What are the competitive and business impacts of the proposed option?

See answer to Question 1.

Question 3: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with an additional option? If yes, which one(s)?

See answer to Question 1.

Question 4: What elements should be included in core data? Why?

See answer to Question 1.

Question 5: How should the cap be set? Please provide as much detail as possible.

See answer to Question 1.

Question 6: Should there similarly be caps applied to non-core data? If so, how should the caps be set? Alternatively, what should staff consider when assessing the fees to be charged for non-core data?

See answer to Question 1.

Option 2) Cap Data fees charged by a marketplace until it meets a de minimis threshold

Question 7: Are there any unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

As stated in the text of our response, we prefer that regulators impose an immediate moratorium on new marketplaces. Further, we would like to see regulators at the very least eliminate data fees for marketplaces that are not materially contributing to price discovery. Market data revenues should not be used to subsidize a small market that is not sustainable on its trading revenue alone.

Question 8: What are the competition and business impacts of the proposed option?



See answer to Question 7.

Question 9: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

See answer to Question 7.

Question 10: What factors could be considered in establishing the de minimis threshold? What could be the appropriate measure and measurement period? Please provide as much detail as possible.

See answer to Question 7.

Question 11: What factors could be considered in setting the cap? Please provide as much detail as possible.

See answer to Question 7.

Option 3) Cap all Data fees for all marketplaces starting at a de minimis threshold and gradually increasing the threshold and the applicable caps

Question 12: Are there any unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

Our thoughts on this alternative are the same as Option 2.

Question 13: What are the competition and business impacts of the proposed option?

Please see answer to Question 12.

Question 14: Would the proposed option be effective in market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

Please see answer to Question 12.

Question 15: What factors could be considered in establishing the de minimis threshold and the successively higher thresholds? What could be the appropriate measure and measurement period?

Please see answer to Question 12.

Question 16: What factors could be considered in setting the gradually increasing caps? What could be an appropriate approach in setting these caps? Please provide as much details as possible.

Please see answer to Question 12.



Question 17: Should the caps for fees be waived when a certain threshold is met? Please provide as much detail as possible.

Please see answer to Question 12.

Option 4) Cap fees for data sold through the information processor (IP)

Question 18: Are there any unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

Please see answer to Question 21.

Question 19: What are the competition and business impacts of the proposed option?

Please see answer to Question 21.

Question 20: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

Please see answer to Question 21.

Question 21: What factors could be considered in establishing the caps?

If caps are to be contemplated, then they should apply regardless of where the data is purchased.

Option 5) Regulate consolidated market data fees charged by the IP

Question 22: Are there unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

The Information Processor model (similar to the US model for Level 1 data) is complicated and fraught with potential problems. There are better alternatives available and discussed in more detail on page five in this response.

Question 23: What are the competitive and business impacts of the proposed option?

Please see answer to Question 22.

Question 24: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

Please see answer to Question 22.

Question 25: How should the fee be set and by whom?

Please see answer to Question 22.



Option 6) Cap consolidated data fees sold by marketplaces to all data vendors, not just to the IP

Question 26: Are there unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes benefit more than others?

This is not the best option. We prefer a model that is utility driven. See page five of this response.

Question 27: How does this option compare with option 4? What costs and benefits arise from offering regulated fee consolidated data through competitive data vendors rather than a single regulated IP?

Please see answer to Question 26.

Question 28: What advantages, if any, would result from being able to receive consolidated data from a number of data vendors?

Please see answer to Question 26.

Question 29: How should the fee be set and by whom?

Please see answer to Question 26.

Question 30: Should data vendors distributing aggregated data under this model be subject to regulation by the CSA?

Please see answer to Question 26.

Option 7) Mandate a data utility to operate on a cost recovery basis

Question 31: Are there unintended consequences at the industry, marketplace or firm level that could result if this option is pursued? Would these consequences be evenly distributed across the industry or will certain types or sizes of firms be more impacted than others?

This is the best of the eight options presented in the comment proposal. However, we prefer the concept of appointing a third party entity as the owner and manager of the utility function, with strong regulatory oversight of this entity similar to the oversight governing a regulated pipeline or utility. See the text of our recommendation written on page five of this response for more details on our concept for data regulation.

Question 32: What are the competitive and business impacts of the proposed option?

Please see answer to Question 26.

Question 33: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

Please see answer to Question 26.



Question 34: Is it sufficient to create a utility, or must its prices also be regulated?

Please see answer to Question 26.

Question 35: Should there be any restrictions on the data to be provided by marketplaces to this utility – e.g., should this data be limited to core data?

Please see answer to Question 26.

Option 8) Publish amendments to market data fees and fee models for comments

Question 36: Are there any unintended consequences at the industry, marketplace or firm level that could result if this option is pursued?

We support the concept of public comment periods for fee changes that affect the access to markets. This includes trading fees. However, we do not think that a comment process for each data fee change will result in the end to the spiralling cost of data, as this solution does not eliminate the core problem – that is, lack of regulation of market data fees.

Question 37: What are the competition and business impacts of the proposed option?

Please see answer to Question 36.

Question 38: Would the proposed option be effective in addressing market data fee issues? Would this option be more effective if pursued with another option? If yes, which one(s)?

Please see answer to Question 36.

Question 39: Would the rationale and the pre-implementation impact analysis be sufficient in assessing whether the proposed fees do not constitute an unreasonable condition on accessing a marketplaces data services? If no, what other requirements should be considered?

Please see answer to Question 36.

We would like to once again thank the CSA for the opportunity to comment on the important topic of market data fees. We encourage the CSA to follow up this comment process with a public hearing on the topic of market data fees (similar to the dark pool session held a couple years ago) and we would be honoured to be considered for participation in such an event.

Yours Truly,



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