

BY ELECTRONIC MAIL: marketregulation@osc.gov.on.ca

September 15, 2014

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

Dear Sirs and Mesdames:

RE: CSA NOTICE AND REQUEST FOR COMMENT PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 23-101 TRADING RULES ("Comment Paper") published on May 14, 2014.

National Bank Financial Inc. ("NBF") appreciates the opportunity to comment on this Comment Paper. We support the OSC's statutory mandate to provide protection to investors from unfair, improper or fraudulent practices, and to foster fair and efficient capital markets and confidence in capital markets.

NBF is part of the diverse National Bank Financial Group ("NBFG") which: (i) manufactures mutual funds, owns proprietary distribution channels and supplies services to third party distributors; (ii) operates a discount brokerage firm; and (iii) is an IIROC-regulated investment dealer across Canada. We therefore take great interest in the regulatory initiatives contained in the Comment Paper and their potential impact on investors, the mutual fund industry, the investment industry and financial intermediaries.

Accordingly, our intention is to share our concerns regarding the regulatory initiatives contained in the Comment Paper and our experiences. We trust that our comments will be taken into account during the review process and also provide a positive and productive contribution to the outcome of the regulatory initiatives proposed in the Comment Paper.

The topics discussed in our comment letter relate to the issues associated with:

- a) The application of OPR;
- b) Best execution policies and disclosure;
- c) Trading fees and
- d) Market data fees.

Amendments to OPR

Let us begin by noting that we believe that the best possible scenario would be to do away with OPR entirely. NBF and the broker dealer community are well governed by best-execution principals and would continue to seek it even without OPR. Not only would this be the simplest solution and easiest to implement, it would give dealers the most flexibility to find innovative ways to serve investors. It would also mean that all exchanges would have to compete on equal footing for order flow.

But as we recognize that a complete deletion of OPR is not being contemplated within this overall reworking of the Canadian market framework, we agree that it's more constructive and generally beneficial to answer the questions within the context they were intended.

Question 1: Please provide your views on the proposed market share threshold metrics, including the types of trades to be included in and excluded from the market share calculations, and the weighting based on volume and value traded. Please describe any alternative approach.

NBF is of the opinion that the 5% adjusted market share calculation based on a combined average share of the volume and value traded (each equally weighted) is the right approach for this purpose. The share of trading over a one-year period is the appropriate amount of time and we agree that it is adequate to apply it at the market or facility level where the marketplace is comprised of more than one visible market or facility.

Using order-based metrics would be more susceptible to manipulation for the purposes of achieving a threshold; we do not support the use of this approach.

Question 2: Is a 5% percent market share threshold appropriate? If not, please indicate why.

We support the proposed 5% adjusted market share to achieve a protection objective of at least 85-90% of the volume to maintain a meaningful level of order protection. This approach alleviates some of the costs and inefficiencies while maintaining order protection to foster confidence in markets and price discovery. It gives dealers operational flexibility and choice on when to connect to a marketplace and allocation of IT and other resources without forcing dealers to connect for a few shares which is not necessarily to the benefit of the end client.

Question 3: Will the market share threshold as proposed help to ensure an appropriate degree of continued protection for displayed orders? In that regard, will the target of capturing at least 85-90% of volume and value of adjusted trades contribute to that objective?

NBF agrees that the market share threshold as proposed will help to ensure a more than ample degree of continued protection for displayed orders and that the target of capturing at least 85-90% of volume and value of adjusted trades contributes fairly to that objective.

Question 4: Will the market share threshold as proposed affect competition amongst marketplaces, both in relation to the current environment or for potential new entrants? Please explain your view.

The market share as proposed will make the marketplaces more competitive, reduce the number of undifferentiated competitors, drive innovation, and increase the quality provided to the market participants.

Question 5: Is it appropriate for a listing exchange that does not meet the market share threshold to be considered to be a protected market for the securities it lists? If not, why not?

We do not support the CSA proposal to protect a recognized exchange that does not meet the market share threshold only with respect to those securities listed and traded by that exchange.

This would impose a significant burden on dealers and vendors to invest in new technology solutions which requires routers to distinguish between markets on a symbol-by-symbol basis. It may also lead to exchanges seeking cross-listings solely for the purpose of seeking some benefit from protected market status, forcing dealers to connect to an exchange for only a handful of stocks.

Question 6: If the Proposed Amendments are approved, should an exchange be required to provide unbundled access to trading and market data for securities it lists and securities that it does not list? Please provide details.

Yes. A below-threshold exchange on which primary listings are deemed to be protected should be required to provide unbundled access to trading and market data for the securities it lists as opposed to those that it does not list.

But as mentioned above, while we appreciate and encourage additional competition in the listings business, the additional complexity is not worth the benefits of this order-protection exception.

Question 7: What are your views on the time frames under consideration for the market share calculation and identification of 'protected market' status?

The proposed annual measurement period is reasonable and should ideally be aligned with the end of a calendar year. A shorter measurement window could impose more costs on industry if there are more frequent changes to the protected markets lists. An annual measurement window will ensure a marketplace has demonstrated some staying power before being protected.

An implementation period of three months after publication of each annual list should be adequate for marketplace participants and marketplaces to make any adjustments to operational processes. Information regarding the threshold criteria and process, including the specifics about time periods covered by the calculation and the effective date and duration of the published lists should be publicly available as proposed.

Question 8: What allowances should be made for a new dealer that begins operations during the transitional notice period with respect to accessing a marketplace for OPR purposes that no longer meets the threshold?

A new dealer that begins operations during the transitional notice period should be given three months leeway with respect to accessing a marketplace for OPR purposes.

Question 9: Are there any implementation issues associated with the ‘protected market’ approach?

Implementation of the protected market approach would cause problems with market data consolidation. Different stakeholders would need different “versions” of an NBBO, which sounds both complicated and somewhat shady.

Multiple NBBO would cause problems for vendors and consumers alike, not to mention involve some reconsideration of compliance oversight on trade-throughs as well as midpoint pricing determinations.

The proposed OPR amendment (as would an entire deletion of OPR) relies more heavily on the best-execution principals and there will no doubt be some considerable work to be done within compliance regimes with regard to order handling policies & procedures.

All of which would be surmountable issues, but warrant a transition period of at least six-months or better yet, a year for implementation.

Question 10: What should the transition period be for the initial implementation of the threshold approach, if and when the Proposed Amendments are adopted, and why?

If and when the Proposed Amendments are adopted, we propose the transition period to effective as early as possible for the initial implementation of the threshold approach and include this year for the metrics calculation.

Locked and crossed markets

Question 11: Please provide your views on the proposed approach to locked and crossed markets. If you disagree, please describe an alternative approach.

NBF agrees that with the changes being proposed to OPR, the provisions relating to locked and cross markets also require amendment resulting in the application of the locked and crossed provisions being limited to protected orders.

Although this would result in an increase in the instances of locked and crossed markets across all visible markets, we think that the outcome represents a reasonable balance between important policy objectives of the prohibition and the goal of addressing some of the costs and inefficiencies of OPR in its current form.

Best execution obligations and disclosure

Question 12: Is the guidance provided sufficient to provide clarity yet maintain flexibility for dealers? If not, what changes should be considered?

We support the CSA view that since there is no requirement under the best execution obligations in NI 23-101 or UMIR that would require all marketplace participants to access trading on all marketplaces, it would not be appropriate to dictate best execution practices or provide a checklist. Dealers need the flexibility to examine their business models and determine their best approach to achieve best execution.

Clarification of what constitutes “best execution”, reiteration that best execution obligations do not apply on an order-by-order basis and that best execution is subject to a “reasonable efforts” test via the OPR amendments is beneficial for dealers in designing their related policies and procedures.

Question 13: Please provide your views on the proposed dealer disclosure to clients.

NBF is of the opinion that proposing some disclosure for dealers at this time is appropriate given how the OPR amendments might introduce added uncertainty for clients around the handling and routing of their orders in the context of unprotected markets. The required disclosure will provide clarity of order handling and routing, and on potential conflicts of interest arising as a result of ownership or fee considerations that could impact its order handling and routing decisions.

Question 14: What should the transition period be for the proposed disclosure requirements, if and when the Proposed Amendments are adopted, and why?

Three to six months is an appropriate transition period from implementation for the proposed disclosure requirements.

Consolidated data

Question 15: Are changes to the consolidated data products provided by the IP needed if the amendments to OPR are implemented? If so, what changes are needed and how should they be implemented?

Yes. As discussed in Question 9 regarding implementation difficulties, the IP would have to provide two distinct NBBO’s for the differing purposes & stakeholders: the entire NBBO as well as a separate, “protected” NBBO for compliance oversight (and, potentially, routers which only intend to interact with protected markets). This complicates the marketplace and risks potential conflicts of interest for the IP as well. We view this as a major drawback of the proposed OPR amendments.

Trading fees

Question 16: Please provide your views on the proposed trading fee caps as an interim measure. Please describe any proposed alternative.

NBF supports the OPR amendment proposal to apply the active trading fee caps to all visible marketplaces to help ensure that fees charged and rebates provided by unprotected markets are not set at a level that may encourage inappropriate trading activities and thereby negatively affect market integrity.

Question 17: What should the transition period be for the proposed trading fee caps, if and when the Proposed Amendments are adopted, and why?

NBF is of the opinion that the caps should take effect immediately upon implementation of the OPR amendments.

Prohibition on payment of rebates by marketplaces

Question 18: Is action with respect to the payment of rebates necessary? Why or why not?

NBF is of the view that the payment of rebates by a marketplace, or any other entity, is changing behaviours of marketplace participants in ways which may be contributing to increased fragmentation and segmentation of order flow, distorting the rationale for investment or trading decisions, and creating unnecessary conflicts of interest for dealer routing decisions that may be difficult to manage.

We are not in favour of rebates and propose a small take / no rebate model which we believe is expected of us as responsible market makers.

Question 19: What are your views on a pilot study for the prohibition of the payment of rebates? What issues might arise with the implementation of a pilot study and what steps could be taken to minimize these issues?

In our view, the need for a pilot study stems from the concern that a prohibition on the payment of rebates could present risks to liquidity, if those currently providing passive liquidity reduce their activity or leave the market. This is a risk particularly for securities that are inter-listed in the U.S. However, we recognize that certain participants who most often receive rebates in the context of their trading strategies also participate in markets without the payment of rebates and will likely adjust their trading behaviour.

Prohibiting rebates could also have greater effect on trading costs for investors' marketable orders if spreads were to widen to compensate for the lack of rebate. At the same time, however, a widening of spreads might also provide increased opportunity for investors to participate and be filled at the quote with passive limit orders, rather than having to 'cross the spread'.

Question 20: Should all types or categories of securities be included in the pilot study (including interlisted securities)? Why or why not?

We encourage the inclusion of all types of securities in the pilot study. Certainly it would be useful to include ETFs. Due to the nature of their NAV-based pricing, they are particularly suited to this kind of cost structure.

We recognize, however, that Canadian markets do not operate in vacuum. And while it is our understanding that the regulators have reached out to their counterparts in the USA, it is unlikely that there will be any coordinated effort between the two in managing the pilot study.

As such, even as we would be very interested in the results of such a study on an inter-listed name or two, we suggest omitting inter-listed securities. Perhaps the results of the Canadian-listed-only study will be compelling enough to further incent a coordinated cross-border effort down the road.

Question 21: When should the pilot study begin? Is it appropriate to wait a period of time after the implementation of any change to OPR or could the pilot start before or concurrent with the implementation of the OPR amendments (with a possible overlap between the implementation period for the OPR amendments and the pilot study period)? Why or why not?

It would be appropriate to commence the study approximately six months after the implementation of the OPR amendments. This will provide time for participants to adjust to the new OPR regime and make the required technical changes while also enabling marketplaces to adjust fees or fee models for trading in those

securities that will be subject to the pilot. It will also reduce the likelihood of the maker-taker pilot results being clouded by the effects of the OPR implementation, making for a more defensible study.

Alternatively, considering that OPR amendments have yet to be ratified and will incur further delays for implementation, a strong case could be made that it makes sense to launch the pilot study *ahead* of OPR implementation.

Question 22: What is an appropriate duration for the pilot study and why?

Six months to a year would be considered an appropriate duration for the pilot to make it a more meaningful and consistent study as long as a representative sample of symbol types and categories is selected (e.g., price, liquidity profile, sector, index inclusion, etc.) for comparison against a control population.

Question 23: If rebates were to be prohibited, would it be appropriate to continue to allow rebates to be paid to market makers and, if so, under what circumstances?

NBF is of the view that no rebates are necessary for designated market makers, and that an active / passive zero fee approach is most suitable in this situation.

Additionally, for ETF market makers, we propose that zero (or reduced) fees be extended to market makers for trades executed for hedging ETF market making positions. We believe that this approach will incent new marketplaces and those below the 5% threshold to differentiate in order to preserve or attract order flow – e.g., they must bring some new or unique value proposition.

In that vein, should rebates be explicitly prohibited, marketplaces may devise alternative incentive plans to find innovative ways to compensate for trading on that market. We propose that the OPR Amendments require marketplaces to provide full disclosure on this front in the interest of transparency for an explicit market making program.

Question 24: Will the implementation of a methodology for reviewing data fees adequately address the issues associated with data fees, or should other alternatives be considered? Please provide details regarding any alternative approach.

The increasing cost of market data has garnered much attention in the last few years with additional visible marketplaces charging for data in an environment where participants were captive to the fees charged in order to comply with OPR and best execution obligations.

We support the approach proposed via the OPR amendments which requires a transparent methodology to assess the relative value of real-time market data provided by each marketplace on an annual basis. We deem it essential at this time to impose more discipline on the costs of data.

We cover market data in significantly more detail below in Questions 31-36

Question 25: Do you have concerns with respect to market data fees charged to non-professional data subscribers that securities regulatory authorities need to address? If so, how should the concerns be addressed?

We note from the information provided in the comment paper that non-professional data subscribers in Canada are provided much less of a discount from professional fees in percentage terms relative to their US

and international peers. While a discount is applied for non-professional data user fees domestically, international comparisons identify even greater discounts being made available.

NBF supports the CSA view that this can be addressed by implementing a cap to restrict each marketplace to charging non-professional data subscribers at a rate set as a percentage of that marketplace's reviewed and/or approved professional data subscriber rate. The level of non-professional fees in Canada should be considered in the context of the CSA mandate to foster fair and efficient markets and provide investors with access to data at a reasonable cost.

We cover market data in significantly more detail below in Questions 31-36

Alternative Approaches Considered

Question 26: Is modifying OPR by introducing a threshold, and at the same time dealing with trading fees and data fees, an appropriate approach to address the issues raised? If not, please describe your alternative approach in detail.

NBF is of the opinion that modifying OPR by introducing a threshold and at the same time dealing with trading fees and data fees is an acceptable approach to address the issues raised. We highlighted at the outset of this comment paper that it remains our preference to do away with OPR in favour of best-execution principals.

Question 27: What is the expected impact of the Proposed Approach on you, your organization or your clients? If applicable to you, how would the Proposed Approach impact your costs?

The expected impact of the Proposed Approach is as noted in Question 9 above.

Question 28: Is the Proposed Approach an effective way, relative to the other approaches described, to support a competitive market environment that encourages innovation by marketplaces? Please explain your view.

Yes.

Though at the risk of repeating, we suggested the following at the outset of our comments:

NBF believe that the best possible scenario would be to do away with OPR entirely. NBF and the broker dealer community are well governed by best-execution principals and would continue to seek it even without OPR. Not only would this be the simplest solution and easiest to implement, it would give dealers the most flexibility to find innovative ways to serve investors. It would also mean that all exchanges would have to compete on equal footing for order flow.

Question 29: Considering the Proposed Approach, is it necessary to take additional steps to regulate membership and connectivity fees charged by marketplaces? If so, why, and if not, why not?

We note that with the proposed changes to OPR, and existing best execution obligations, it is not necessary for each dealer to become a member or subscriber of each visible market, or directly connect to each market to access trading. For example, it is a questionable practice for a marketplace to ask for

payment for the same data by terminal if it is accessed by a number of different users within the same organization. In connection with ongoing oversight of marketplaces and market structure, we urge the CSA to consider directly regulating fees charged by marketplaces for membership or connectivity as these can be fairly high and will only be mitigated to a certain degree with the implementation of the proposed OPR amendments.

Question 30: Considering the Proposed Approach, is it necessary to take additional steps at this time to address issues relating to marketplace liability? If so, why, and if not, why not?

We note the argument that liability terms in marketplace agreements maybe a commercial, not regulatory issue. However, we are not certain that the proposed OPR amendments will help mitigate this issue. We understand that there is no regulation in the U.S. that requires any liability compensation provisions, however, we urge the CSA to consider incorporating provisions in the rules of Canadian exchanges in order to protect market participants from losses arising from failures of the exchange or ATS' systems or due to their employees' negligent acts or omissions.

Data Fee Review Methodology

Question 31: Taking into consideration how these pre-trade metrics will be used within the various ranking models, are these reasonable proxies for assessing a marketplace's contribution to price and size discovery? Are there other metrics we should consider? Please provide details.

In measuring a marketplace's contribution to price discovery, consideration should also be given to the level (or quantity) of order flow that is published on the market data feeds since every market participant must consume and process market data in order to provide best execution.

Furthermore, using median in addition to average will help gauge skewness and provide a better measure of a marketplace's pre-trade metrics in the various ranking models (ie, the median is harder to artificially bias). Market microstructure statistics are typically distributed asymmetrically and have large outliers which can skew the average.

Question 31a: Order Duration

Order duration is a metric that can be used to assess a marketplace's contribution to price and size discovery. Order duration is computed by measuring the time difference between when an order first enters the displayed order book until it is modified (cancelled or changed).

The typical resting time (i.e. order duration) of a marketplace's posted orders is a measure to help assess the quality of liquidity that rest in the limit order book. Longer-lived orders increase the likelihood of a trade for market participants reacting to quote changes compared to fleeting orders. The definition of fleeting should be close to the intrinsic round-trip time constant of trading infrastructure for a typical market participant.

In context of Canadian markets as a whole, for certain symbols and market place combinations, the distribution has been found to be extremely skewed towards fleeting orders. A marketplace with a high level of fleeting orders also distributes proportionately more market data, resulting in higher infrastructure and computing through-put requirements for all other participants.

The average and median order duration metric for the whole market place can be equally weighted or volume-value-weighting can be used. It is preferable to have marketplaces with longer order duration metrics. The construction of this metric requires processing full depth-of-book orders and is computationally intensive.

In terms of robustness, the distribution of order duration for a marketplace is intrinsically difficult to manipulate. It is difficult to artificially increase the proportion of long-lived orders as they must persist for a long period of time. Furthermore, using order duration will help flag manipulation of pre-trade metrics.

The weakness of the order duration metric is that order activity is inherently event-driven. High market volatility will result in more orders submitted to marketplaces at a fast pace mimicking fleeting orders. One workaround is to use a relative rather than absolute order duration measure by ranking all the marketplaces. If market conditions merit a high rate of order activity, all marketplaces should be similarly affected and a marketplace's ranking amongst its peers will not be materially altered.

Question 31b: Quantity of Market Data

The quantity of market data (message traffic) that is produced by a marketplace should be a factor in measuring a marketplace's contribution to price discovery and liquidity. While message traffic does not directly measure the quality of price discovery, it has a significant impact on market participants. As the level of order activity increases, the infrastructure costs required to keep pace also increases, directly impacting the overall cost of trading.

Question 32: Are the pre-trade metrics described appropriate for a marketplace that predominantly trades less liquid securities? Please indicate and describe what pre-trade metrics would be appropriate to use for such a marketplace.

Appropriate metrics have been covered in the related questions above.

Question 33: Taking into consideration how these post-trade metrics will be used within the various ranking models, are these reasonable proxies for marketplace liquidity? Are there other metrics we should consider? Please provide details.

Similar to #31 above, the median in addition to average should be used to calculate post-trade metrics.

Question 34: Are the post-trade metrics appropriate for a marketplace that predominantly trades less liquid securities? Please indicate and describe any additional post-trade metrics would be appropriate to use for such a marketplace.

Similar to #31 above, the median in addition to average should be used to calculate post-trade metrics.

Question 35: Are the ranking models described appropriate for ranking a marketplaces' contribution to price discovery and liquidity? Are there other ranking methods we should consider? Please provide details.

The level of market data that is produced by a marketplace should be factored into the ranking of a marketplace's contribution to price discovery and liquidity.

The messages-to-market-share ratio provides the link between the quantity of market data and traded volume. This metric evaluates the relative efficiency of a marketplace compared to its peers. Calculating this metric only requires counting the full depth of book messages and is computationally straightforward.

Question 36: If you had to choose one of the three ranking methods described, which method would you chose and why?

The ranking model should be a combination of pre- and post-trade metrics, factoring in order duration as well as messages-to-marketshare-ratio.

The four components shed a different light into the value a marketplace provides and should be weighted equally in calculating the final ranking metric.

In addition to having a single scalar value ranking the marketplaces, a multi-factored vector measure should also be considered. This will provide transparency into which factor(s) a marketplace is weak on and allow trading participants to draw their own conclusions.

We have attempted, above, to balance brevity and detail, but should the regulators wish to follow-up directly with us on for more details on our suggested methodology, we would be happy to help.

NBF appreciates the opportunity to comment on this significant development in the Canadian trading landscape.

We look forward to our continued participation in any further public consultation on this topic and our objective is to find solutions that are relevant for, and serve the needs of the Canadian market. NBF and its employees are willing to take a leadership role in this issue participating in consultations with investors, industry participants and the CSA.



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