chi-x™ CANADA

September 19, 2014

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority (Saskatchewan)
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Re: CSA Notice and Request for Comment - Proposed Amendments to National Instrument 23-101 Trading Rules

Dear Sirs/Mesdames:

Chi-X Canada ATS Limited ("Chi-X Canada" or "we") operator of Chi-X Canada ATS and CX2 Canada ATS marketplaces welcomes the opportunity to provide comments on the Canadian Securities Administrators ("CSA") Notice and Request for Comment regarding proposed amendments to National Instrument 23-101 *Trading Rules* ("NI 23-101") ("Proposed Amendments"). As outlined in Annex A of the Notice to Proposed Amendments ("Notice") staff undertook an extensive review of the impact of the Order Protection Rule ("OPR") including interviews with over 35 representatives from the buy-side, sell side and other stakeholders. We commend staff on the time and effort taken to conduct this review while considering what, if any changes may be necessary to the existing OPR rule. Given the interconnectedness of issues related to OPR, including marketplace fees and competition we recognize Proposed

Amendments as an attempt to balance the policy objectives of OPR, while recognizing that at today's stage of competition for marketplace services that the need for OPR may have changed.

We would like to observe that while understanding Proposed Amendments are being proposed to address some unintentional consequences of OPR, the CSA is now formally moving to become a "fee regulator" as it considers imposing prescribed limits and a methodology for approving marketplace fees. Given current practice where all fee changes by marketplaces must be justified as reasonable without clear criteria for what constitutes reasonability, we commend the CSA on bringing transparency to this process. That being said, fee regulation requires unique economic considerations that are different from those of market structure. We encourage the CSA to explore options into acquiring resources with expertise in this area in order to better understand what impact market structure policy may have on competition. This could take the form of additional hiring or secondments from other regulators such as the Canadian Competition Bureau or the International Monetary Fund.

We have presented our response in eight sections with high-level introductory comments followed by answers to specific questions asked in the Notice.

SECTION ONE – ORDER PROTECTION

Not long after competition was permitted by regulation, discussion took place whether or not some form of order protection should be introduced. The policy rationale for introducing OPR was to ensure a level and fair playing field for all participants and that an order entered on a marketplace would be treated the same irrespective of its size and the sophistication of the user.[1] Retail confidence was prioritized with little language about OPR's impact on competition generally and specifically how the rule would foster competition with the incumbent for market share. Also at this time, the decision was made to introduce a highly prescriptive form of order protection, driven out of the recognition that order protection is an obligation owed to the marketplace as a whole and cannot be waived by a client on an order-by-order basis.

We understand that over time regulation needs to be reassessed to ensure it continues to meet policy objectives given the potential for unintentional outcomes and developments created by a rule. This being said, the primary consideration for Proposed Amendments appears to be driven by concerns about costs resulting from OPR, particularly for dealers.

In Annex A of the Notice, little information was provided about feedback from the retail constituency regarding the importance it places on the existing OPR framework and the level of risk to investor confidence is introduced by lowering today's OPR standard. We believe it is

[1] Notice of Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules published on October 17 2008.

critical to ascertain feedback from this constituency because the issue of investor confidence is largely one of perception. The optics of a trade-through for an investor without sufficient market knowledge and understanding of the regulatory framework could potentially negatively impact investor confidence.

Without judging whether the costs of OPR now outweigh the benefits, we note several observations from our experience operating a marketplace in Canada over the last 6 years. First, although we recognize certain issues with the captive consumer argument, the extent to which this argument applies to today's market structure is unclear. The need for dealers to connect to all marketplaces and consume their market data is dependent on the business lines that are supported by each dealer and their sensitivity to latency and price. This is supported by the view of the CSA, which has never mandated connectivity to each venue as part of OPR or Best Execution.

As mentioned in the Notice, certain dealers have identified opportunities to lower their costs through innovative solutions, whereas others continue to support a costly environment that could be better rationalized. The OPR review cites examples of certain smaller firms implementing jitney arrangements in order to lower monthly marketplace fees. The Notice also mentions that select dealers are working toward a solution for trade compression to lower their back office ticketing costs.

We believe that although multiple marketplaces have operated for over 6 years, there continues to be benefits for both dealers and their clients that are not being utilized today. The majority of dealers post almost exclusively on the primary listing market despite other marketplaces offering lower fees and smaller order queues. This behavior not only questions whether sufficient analysis has been performed on how to benefit from trading in a multiple marketplace environment but also may evidence the slow adoption from certain participants of new products and other marketplace developments.

For over two years all marketplaces have had their fees regulated, however without transparency. An example of this was the introduction of market data fees by Chi-X Canada. Although at that time, Chi-X had around 10% market share, it was difficult to introduce fees already charged by marketplaces with lower market share. In response to dealer concerns about being captive consumers, marketplace fees have been highly scrutinized by the CSA which has led to either downward pressure on their fees or requiring justification to maintain existing fee levels. This demonstrates that the net-benefits of OPR including consideration of costs have already been an area of focus by the CSA and that action has already been taken. From discussions with clients we have heard that this is not their perception and that communication about this practice has been absent.

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Answers to specific questions on OPR are provided below:

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.

We agree with the types of trades that are included in the threshold calculation and the exclusion of trades that are either restricted to a specialty trading session, special terms orders or that are not the result of a response to an available visible bid or offer with which to interact.

We question, however, why the proposed calculation for determining the threshold recognizes only volume and value and does not include consideration for the number of trades. Ignoring the number of trades as a legitimate market share metric represents a significant change from the methodology used to calculate market share for regulatory purposes. Since the introduction of National Instrument 21-101 ("NI 21-101") there has been a market share threshold whereby ATSs were required to notify the CSA if they reached or exceeded this threshold measured by volume, value or number of trades. This notification threshold served as the purpose for the publication and methodology used by IIROC for its monthly market share statistics available to the public.

A more recent example is the introduction of new participation fees for specified regulated entities as part of OSC Rule 13-502. A marketplace is required to pay an annual participation fee based on its Canadian trading share for the period. Fees are determined by market share tiers; from 0 – 5%, 5 – 15%, 15 – 25%, 25 – 50%, 50 – 75% and 75% and above. For calculation purposes, market share is determined by the simple average of volume, value and number of trades. Finally, we bring attention to the proposed metrics for evaluating the value of a marketplace's market data as part of Proposed Amendment. Where various metrics have been proposed to assess the value of a market's data on a post trade basis, each of volume, value and number of trades has been included. We propose that a consistent approach should be taken and that all three market share metrics are included in the calculation for the order protection threshold.

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

We do not feel we are in a position to comment on whether 5% is appropriate. Although we recognize that the rationale for this metric is derived from the policy objective to protect 85 – 90% of all visible quotations, we fail to understand the rationale for choosing this objective and the 5% threshold that derives from it. Why is 90 – 95% of all visible quotes not the right number or alternatively why not 80 – 85%? We ask the CSA to provide data driven support for this stated objective so that we can better understand its rationale.

We observe that if this threshold becomes effective only two competitors and four venues will qualify for protected status; one of which will control three of four protected venues. We question whether a lower threshold could be used to allow a more competitive environment. Given that protected status will likely determine the commercial viability of those marketplaces, we suggest that it may be more prudent to take an approach where a lower threshold is used so that more trading platforms can qualify and then revisit if a higher threshold is needed over time.

We note that if the policy objective to protect 85 – 90% of all visible protected quotes is used to implement Proposed Amendments that the individual market threshold should be adjusted if the market share represented by protected marketplaces falls below 85%.

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?

Please see our comment above.

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.

Protected marketplaces may enjoy the benefit of having their quotes be prioritized over those of an unprotected marketplace at the same price due to regulatory compliance. This inherently offers a competitive advantage to protected marketplaces. That being said, a larger issue we see is the ability for existing and new marketplaces to compete for protected status.

One step we believe will assist in intensifying competition is a more rigorous approach to best execution. Acknowledging the inclusion of proposed disclosure and guidance in Proposed Amendment, we believe that there is additional benefit if IIROC intensifies its reviews of dealer best execution policies including requiring answers to be given to more focused questions on trade desk reviews.[2] We believe this will result in better trading decisions being made that will take advantage of competing product offerings and pricing between both protected and unprotected marketplaces.

[2] See suggested additional guidance in Section 3 Best Execution.

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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 believe it is inappropriate for a listing exchange that does not meet the market share threshold to be considered a protected market for the securities it lists because it offers an inherent advantage for listings venues over non-listing venues. The ATS Rules introduced competition between marketplaces in order to compete with one another for trading services; ATSs were purposely given a lower regulatory burden in order to foster competition. Over time ATS and exchange regulation has been harmonized with both types of marketplaces continuing to compete for order flow. Protecting an exchange for its own listings is counter to this approach to competition and would offer an unfair advantage to the incumbent exchange. Given today's listings universe the TSX and TSX-V would be protected for over 94% of all listings whether or not they qualified for protection by exceeding the threshold.

Additionally, the listings business already has its own discrete commercial benefits – listing fees, reputational brand etc. Companies looking to list must always consider the size of the market, regulatory framework, exchange listing standards and ongoing requirements and fees. When a company chooses to list it is aware of these considerations and should know the liquidity profile of the exchange on which it lists.

Unconditional OPR protection for listings may create an incentive for a previously unprotected marketplace to attempt to list securities to force participants to connect to it on the basis of OPR protection.

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.

As outlined in our answer to Question 5 above we do not believe that listings on a marketplace that otherwise does not meet the OPR threshold should be protected. However, if the CSA decides to protect these listings then we believe that an unprotected listing exchange should be required to provide unbundled access to trading and market data for its protected and unprotected names. Without a requirement to provide unbundled services, dealers may be required to purchase services that they otherwise would not voluntarily subscribe.

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

We believe that the time to calculate each market's adjusted market share for the purposes of assessing their protected status needs to strike the right balance by taking into consideration short-term market share trends and the time necessary for dealers to adjust for a market that

moves from unprotected to protected status. We believe the proposed 12-month period achieves this.

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

There are several implementation issues associated with the proposed "protected market" approach. One issue is that this will result in the creation of a National Best Bid and Offer ("NBBO") for protected marketplaces recognized for regulatory purposes and another for unprotected marketplaces. This will create confusion for participants and issues for market data vendors. Secondly, as discussed in the following section, this approach raises issues for the existing locked and crossed market prohibition. Allowing orders entered on protected marketplaces to lock and cross the quotations of unprotected marketplaces may create confusion on any consolidated market data products attempting to include both protected and unprotected quotations. Finally, an issue will be created for the prices used as reference prices for mid-point dark orders. Using the mid-point of the protected NBBO may lead to mid-point trades that are inferior to the true mid-point of all lit marketplaces that are used today.

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?

We suggest that the implementation period for the initial implementation of the threshold approach should be 3 months as proposed. Connections to all markets have already been established, so significant changes should not be required in the initial implementation period.

SECTION TWO – 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.

We understand the rationale for making changes to the application of the locked and crossed market provisions in NI 23-101, however, as proposed, permitting protected markets to lock and cross unprotected markets will result in investor confusion and lead to other inefficiencies. Instead we suggest an approach whereby a participant is prohibited from intentionally locking or crossing an unprotected marketplace to which it has access.

Taking this approach will still recognize that dealers are free to make best execution decisions about which marketplaces they access while also prohibiting behavior that may be damaging to market quality and market integrity. We reiterate, that since the majority of dealers are already connected to all marketplaces, they will probably continue to stay connected when the rule is

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implemented thus limiting the number of crossed and locked markets if our suggested approach is taken. We also restate our view that the consideration to connect to a marketplace should be made based on best execution criteria and not the demands of compliance obligations.

SECTION THREE – BEST EXECUTION

Best execution as an obligation owed to clients in a multiple marketplace environment has been explicitly part of the Canadian market since the introduction of the ATS Rules. In 2008 the CSA provided clarification of factors to consider beyond price including speed, certainty and the overall cost of the transaction. However, given the approach taken to OPR, other considerations around how to seek the most advantageous execution terms reasonably available under the circumstance was largely limited to price, as each better-priced order must be executed ahead of any inferior priced order. Still, given advancements in trading technology and marketplace infrastructure, providing a client with best execution requires more than just seeking the best price for a single order but also includes how multiple orders are routed and whether dark liquidity is used.

In Proposed Amendments new requirements are being proposed to increase the transparency of order routing practices on behalf of their clients and to address dealer conflicts resulting from ownership interests. In addition, new guidance is provided in the NI 21-101CP outlining certain factors that may need to be taken into consideration when deciding whether to connect to a marketplace it does have access to.

We applaud the CSA for expanding guidance relating to dealers' best execution obligation and mandating that information about best execution considerations is made publicly available to clients. We believe that requiring this information, which includes an obligation to report any potential conflict of interest between a dealer and the marketplace, should not only equip clients with better information to evaluate the quality of their execution but also assist new clients in selecting which dealers best suit their needs.

We believe that the proposed guidance for best execution can go further and that the majority of the specific considerations outlined in proposed section 4.1(6) for assessing whether or not to connect to a marketplace that a dealer does not have access to should be applied to order routing decisions as well. At a minimum these considerations can be included in proposed section 4.4(1)(c)(ii) so that best execution policies explain the rationale for not only the marketplaces that are accessed but where marketable and non-marketable orders are sent including considerations around the order in the routing table they use. We believe that factors such as the size and depth of quotations on a market, traded volumes, and market share apply equally to making routing decisions. We also believe that other factors such as execution rates per market ("hit rates") and consideration for how available order types are used would raise the standard

for best execution and ultimately benefit the client community. Finally, dealer policies should include consideration for the use of dark pools and dark orders on lit marketplaces. Recognizing sensitivities around proprietary strategies there is still room for significantly more information than is being made available today.

Our belief that best execution policies can be improved is supported by IIROC's best execution survey. Dealers who were surveyed anonymously provided information about several best execution practices that we believe could be improved. Below are just a few findings of concern:

- Only 82% use a SOR and of those that use them 62% use spray routing strategies exclusively;
- Certain firms had no process for determining how to achieve best execution;
- Occurrence of infrequent reviews of routing tables despite pricing changes made by marketplaces;
- Only 38% indicate that orders are sent to dark pools. This begs the question how dark liquidity is considered in general including dark orders on lit venues;
- Disparate practices regarding when, if ever, marketplace rebates and/or fees are passed to clients;
- Majority post orders on primary market.

The survey confirmed that many dealers send the majority of their passive orders to the incumbent exchange with little consideration of other alternatives. This is troubling from a best execution perspective given that an overflow of orders on any one marketplace will crowd the queue and decrease the likelihood of execution. The reasons for this behavior could be because the TSX offers the highest rebate or an example of slow adoption of marketplace changes implying that many dealers have not performed proper due diligence to understand the additional tools available to them in today's market. In the case of the latter, this could represent a significant opportunity costs.

In addition to suggesting that more guidance is needed, we also encourage greater oversight of best execution policies and note that only a few best execution enforcement actions have been taken. Understanding that best execution is not a bright-line test, we believe that greater focus on trade desk reviews will help to improve certain suboptimal practices used today. During reviews questions can be asked about the additional guidance related to best execution policies outlined above.

Finally, we believe that education initiatives should be launched concurrently with Proposed Amendments. Given recent questions that have been raised about the fairness of today's market structure this should not only positively impact investor confidence but enable the investor community to better assess the services offerings and to select service providers that are right for them.

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

Please see suggestion for additional guidance for order routing above.

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

We support these new requirements as a minimum standard. We note that the scope for disclosure of conflict of interest typically includes perceived conflicts in addition to actual ones. For example under 21-101 all marketplaces are required to provide their policies for identifying and managing conflicts, actual or perceived, related to the operation of the marketplace or the services it provides. We recommend that as part of the proposed disclosure requirement that perceived conflicts of interest as well as actual ones are also included.

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

Given the importance of best execution to investor protection, we believe that the transition period for the proposed requirements should be expedited. Understanding that different dealers have different resources and levels of sophistication in their existing policies we suggest between 3 and 6 months is appropriate.

SECTION 4 – INFORMATION PROCESSOR PRODUCTS

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?

The purpose of the Information Processor ("IP") is twofold: first, where there are multiple marketplaces trading the same securities it will provide at least one source of consolidated data, and two, it will facilitate compliance by marketplace participants with relevant regulatory requirements.[3] If Proposed Amendments are implemented we do not see any reason for changes made to consolidated data products as they continue to serve these two purposes. We believe it is beneficial to have at least one source of consolidated data for those that want to use it. Additionally, removing unprotected marketplaces from consolidated products risks confusion, particularly for investors who will see marketplaces operating in Canada on the IIROC website that are not included in their IP feeds. The less familiarity and knowledge an IP customer has of Canadian regulation, the higher the risk of confusion.

[3] Section 2 of Canadian Securities Administrators Staff Notice 21-309 Information Processor for Exchange Traded Securities Other than Options.

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The second purpose for the IP is to facilitate compliance by market participants with regulatory requirements. At the time that the IP was launched, regulatory requirements included the tick test for short sale and market stabilization compliance, Best Price and Best Execution. Best Price Obligation has been rescinded and Order Protection is now an obligation placed on the marketplace and not a dealer responsibility unless the dealer chooses to take back the obligation by sending DAO orders. In this instance a dealer would not usually rely on the IP to send DAO orders. The tick tests have been repealed for short sale and market stabilization leaving best execution as the primary regulatory requirement the IP can be used for compliance reasons.

If proposed amendments to OPR become effective, dealers will connect to different marketplaces as part of their best execution policies. Although some may exclude certain marketplaces in their policies, others will include them all. Consequently, IP consolidated products should be able to serve all dealers irrespective of whether or not they are connected to all marketplaces. However, given the different treatment of protected and unprotected marketplaces we believe that unprotected marketplaces should be identifiable. This can be accomplished with a marker.

SECTION FIVE – TRADING FEE CAPS

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

We support the proposed trade fee caps. As evidenced by statements made by Aequitas Innovations,[4] a cap on active trading fees has been already effectively in place as no marketplace has been permitted to introduce an active fee that is higher than the highest fee currently in use. However, we understand this to have been an informal cap in the period before Proposed Amendments were published and the CSA could seek comment.

The Notice mentions that the CSA was told that marketplaces take advantage of captive consumers in order to charge high active fees. We would like to clarify from a marketplace perspective that the revenue generated from today's commonly accepted pricing model is not determined by the fee applied to the active trade. Instead revenue is generated by the difference between the fee charged for the trade and the rebate provided. When setting fees, a marketplace must consider a rebate that is economically valuable enough to attract competing liquidity providers while also not charging an active fee that is too high so that active trades are directed elsewhere. Understanding that many marketplaces offer lower active fees for different priced securities or types of securities, we understand part of the problem is related to the challenge of changing dealer behavior and using alternative venues.

[4] Aequitas Innovations has stated that it will set the fee for active trades to be the highest fee permissible by regulation.

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We see value in setting a ceiling on the active fee that can be charged by a marketplace. As stated in the Notice, given that approximately 40% of the total volume traded in securities over $1.00 trade above the proposed cap, its introduction should significantly decrease costs.

One point we would like to be clear on is that if a cap is introduced there will be little need for marketplaces to justify reasonability when making pricing changes that are below the cap.

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

We believe that the implementation of proposed trading fee caps should occur as soon as possible after approval for Proposed Amendments is received. Fee changes by marketplaces are made routinely and seamlessly. Given the cost savings to participants that will result in implementing the 30 mils fee cap, we see no reason to delay.

SECTION SIX – MAKER TAKER AND PILOT PROGRAM

Proposed Amendments include a proposal by the CSA to conduct a pilot program that will prohibit the use of rebates for selected securities. The justification for this proposal is the concerns that rebates, included as part of the maker-taker model or the inverse taker-maker model incentivize behavior in ways which may have a negative impact on the market. We question some of these concerns, and see the maker-taker as a marketplace incentive and that existing issues in the market will continue whether or not rebates are banned. We also believe that several of these issues can be addressed by taking alternative action. Cited concerns around the issue of marketplace rebates include:

- Increased fragmentation and segmentation of order flow;
- Conflicts of interest arising from dealers being incentivized to post orders on a venue with the highest rebate and route orders to venues with the lowest fees;
- Transparency issues with quoted prices because of unequal practices where rebates are passed on to some clients and not others; and
- Increased intermediation on highly liquid securities.

Fragmentation

We believe that the CSA needs to take a balanced view between fragmentation and competition. Fragmentation is a natural result of competition for trading services. By increasing the number of trading venues it becomes more difficult for a natural buyer to locate and match against a natural seller. However, there is a trade-off for the benefits of competition including lower costs, greater innovation and overall improvement in the level of service. This has been seen in Canada where

the introduction of competition has led to the introduction of new marketplace features the development of more efficient technology and downward price pressure for fees.

The Notice states that a view was expressed by stakeholders that the primary motivation for marketplaces to operate multiple venues is to differentiate its pricing model. We take exception to this view given our experience with CX2 Canada ATS ("CX2"), and instead suggest that issues such as technological complexity need to be considered when deciding to introduce new marketplace features. As an operator of Chi-X Canada ATS, the only fully anonymous trading venue in Canada that did not support broker preferencing, CX2 was intended to not only allow Chi-X Canada to compete with other venues that supported attribution and broker preferencing but also to introduce broker preferencing for anonymous orders by default. This feature, coupled with the unique inverted maker-taker model, was CX2's value proposition. However, after comments were raised about the complexity that this functionality would impose on existing smart order routers and other trading tools, a decision was made to not include this innovative feature. Consequently, CX2 was launched with a unique structure and pricing model intended to offer participants that were concerned with higher trading costs the opportunity to be rewarded for their order flow. This is altogether different than operating a second market to only compete on fees.

We note that although marketplaces have been competing on price since they began operating, pricing alone has not resulted in success for many venues. We also acknowledge that it is possible for a venue to generate revenue without necessarily adding differentiated services or value because of OPR. We believe that any regulatory subsidy that is created by OPR is greater for market data fees than trading fees. A trading venue will still garner a certain level of market share if it is last on a routing table due to OPR but this generally is not sufficient to cover the costs to operate. Instead, given the proposed methodology for determining appropriate market data fees in Proposed Amendments, market data fees will be determined by a marketplace's rank which in turn will entitle it to a portion of the total overall aggregate fees. This approach should result in marketplaces charging market data fees that are proportionate to the value of that marketplace's market data.

Finally, any new potential marketplace may reconsider its willingness to invest significant capital into a new marketplace that will be required to overcome the hurdle of having to prove it is relevant before being compensated by market data revenue.

Conflicts of Interest
The Notice raises the issue that the maker-taker model creates a conflict of interest for dealers by incentivizing them to route client passive orders to the venue that offers the highest rebate while routing marketable orders to the venue with the lowest taker fee. IIROC's best execution survey confirmed that this theoretical conflict is real. Like any other conflict of interest, internal controls need to be put in place to manage the conflict. This, coupled with strong regulatory oversight of a dealers best execution policies, should go far in addressing the issue.

Proposed Amendments require that dealers disclose conflicts around the marketplaces they send orders to and their ownership interest. However, we believe that rebate practices including the dealer's practices on the pass-through of rebates to customers should also be required information that is available to clients. Not only will this increase the level of dealer accountability but will also lead to opportunities to educate clients on the reason for existing practices.

We also note that if the maker-taker model is prohibited by regulation that differentiated marketplace fees will continue to create a conflict unless all fees are passed on to the end client. A dealer will still be incentivized to prioritize cheaper venues over best execution considerations.

Transparency Issues
The Notice raises the issue that absent a mandate that rebates are passed on to all customers that different economic outcomes result for trades by different clients. We believe that if transparency around dealer practices relating to rebates is provided to clients then issues of unfairness will be addressed. We recognize today that client execution commissions are not standardized across clients. Institutional clients negotiate their own pricing with each broker and larger clients are able to negotiate better commission rates. Additionally, retail investors are given different commission rates depending on the number of trades they execute in their account. When looking at trading costs holistically, the impact of the pass through of rebates to only certain clients is less significant, provided information about such practices is available to all clients.

Increased Intermediation on Highly Liquid Securities
As discussed in the trading fee cap section, the nature of liquidity provision by market makers is a function of the economics of the bid-ask spread and making a spread tight enough to compete with other market makers. Leaving the performance of a market maker aside, markets will be made differently for different types of securities depending on their liquidity and volatility profiles. While the Notice correctly observes that there may be excessive intermediation for certain highly liquid securities, we do not understand this to be the result solely of the maker-taker model but instead that the model simply accentuates an already present issue. Rebates offered by the maker-taker model simply impact the economics of market making. By banning this model there will continue to be a high level of intermediation on these securities. Given the low volatility and volume characteristics of a certain securities market makers will still be more active on these names because the behavior of these security best suits the objectives of a market maker.

Banning rebates because of excessive intermediation also does not address a larger issue in the market of how to attract liquidity to less liquid securities. The issue of illiquidity for small cap and medium cap securities is now being faced in different global jurisdictions but is of particularly importance in Canada given that the majority of listed securities are not liquid, especially TSX-V listed securities. Banning rebates across the board will impact liquidity

provision on these names. Without the economic incentive that a rebate provides, spreads will likely widen resulting in higher implicit fees for investors.

Recognizing that certain securities will always be more attractive to liquidity providers than others; we do not see the maker-taker model itself as the root problem, but as an example that with any one-size fits all model it works best for some names versus others. Concerns may be raised for large capitalization securities however; the model affords incentivizing better markets for less liquid securities. Without applying different pricing models for securities based on characteristics such as their liquidity or volatility profiles, the benefits will always be applied in some areas and not others. In taking a tiered approach, the recognition and different treatment of each tier will add further complexity to an already complex market structure.

Maker-Taker Pilot
Banning rebates on any security represents a significant change to our market structure that in turn risks unintended consequences. We therefore ask that the CSA consider a much smaller number of names to be included for the universe of pilot securities than the one third to one half of all securities listed suggested in the Notice. We also believe that the CSA should closely monitor the program (with the assistance of IIROC) and that it is able to terminate the program if any significant negative impact is observed.

We also caution the inclusion of any inter-listed names without coordination with the SEC. Although the SEC's recently announced pilot program to increase the tick size for certain small cap names includes several inter-listed securities, unlike Canada, the best execution in the US does not require a participant to consider foreign markets when trading in inter-listed names. Consequently, including inter-listed names in any rebate pilot program will risk a loss of volume to the US on names that represent roughly 25% of our market.

Finally, we believe that the issuer should be consulted when considering its listed security to be included in the program. Given that there is a chance for significant changes in behavior, issuers should be given the right to elect to opt-out of participation.

With regard to the construction of the program itself, we believe it of essential importance that the explicit objectives of the program are specified and the rationale for each objective is given. Furthermore we ask that the CSA specify how these objectives will be monitored and the basis for determining the program's success or failure. Given the advancement of data retention and analysis, other global regulators are now looking at the impact of previous rule changes that may have had significant unintended consequences. We believe that Canada is uniquely positioned because of IIROC's data warehouse and access to an independent third party capable of quantitatively measuring any impact.

Finally, regarding Question 23, we are strongly against continuing to allow rebates to be paid to market makers if a pilot is conducted. Today, registered market makers prominent contribution is

facilitating trades for retail investors through the executing of odd lots and honoring the minimum guarantee fill. Market makers already enjoy the benefit of being exempt from paying regulation fees for trades on their securities of assignment. Permitting rebates for market makers would offer them a significant advantage over all other participants especially during a pilot program whose unintended consequences are not known at this time. It would also offer a significant advantage to exchanges over ATSs due to regulatory arbitrage given that ATSs are prohibited from supporting formal market making programs under securities law.

SECTION SEVEN – MAKER DATA FEES

We support Proposed Amendments that will make the existing regulation of marketplace fees transparent. We believe that using a methodology that is applied consistently across marketplaces ensures fairness.

We also support Proposed Amendments that will require marketplaces to resubmit their professional market data fees annually for approval. Providing certainty for the methodology for regulating these fees and the requirement for marketplaces to reapply, will lead to a more efficient distribution of market data fees across marketplaces. Today, existing market data fees are not fairly applied. Similar fees are charged by marketplaces that have lost significant market share, while others have significantly increased their market share since their fees were approved.

Regarding the CSA's consideration of whether further action should be taken to regulation market data fees for non-professionals we believe that given the stated methodology for professional users that applying 30% of the cost of professional users is appropriate for non-professional users. We believe using this type of firm guideline is appropriate given the different usage of market data fees by professionals and non-professionals.

We also note that issues around the current cost of non-professional fees only apply to fees charged by the incumbent. Retail brokerage firms typically only supply the incumbent's data to their clients resulting in only a partial view of the market. The offering can be enhanced by supplementing it with free data where available. For example there are no market data fees for non-professional users for both Chi-X Canada ATS and CX2 Canada ATS. Although the question remains outstanding as to whether there are sufficient free market forces to price market data, at the very least dealers are empowered today to put competitive pressure on existing prices by taking advantage of alternatives available to them.

SECTION EIGHT – MARKETPLACE LIABILITY

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?

The regulatory risk and the business and reputational risk of losing the confidence of existing customers, new prospects, and other stakeholders, lead marketplaces to take very seriously the requirements for staff and resources needed for the development and maintenance of proper market systems. Requiring any further steps to address issues relating to marketplace liability suggests that marketplaces are not sufficiently incentivized to operate in accordance with the highest standards and in the best interest of the markets. We believe this view is unsupported and objectionable.

Whereas the SEC has only recently proposed to introduce new regulations for marketplace systems in Regulation SCI, the existing regulatory framework for marketplaces under NI 21-101 has already included requirements that are robust and sufficient to protect participants from undue risk of systems issues and support capital markets. Further, over and above the regulatory requirements, marketplaces have compelling business incentives to avoid system issues and manage any issues that arise in an appropriate manner. Marketplaces operate in a global competitive environment and are highly motivated to minimize system risk.

In 2013, we reviewed the trading rules and member agreements of 16 equities marketplaces (TSX, TSXV, TMX Select, Alpha, Omega, Chi-X Canada, CNSX, NYSE, NASADAQ, ASX, BATS CHI-X Europe, DEUTSCHE BOURSE, LSE, LSE AIM, SGX, and HKEX) in 5 different regions (Canada, U.S.A. Europe, Australia, and Asia) and found that these marketplaces disclaim liability either fully, or with carve-outs only for willful misconduct, fraud, and gross negligence.

Furthermore mandating a required liability provision will represent a significant change in market structure that will substantially alter the risk profiles of all marketplaces. The existing marketplaces have established business models based on the existing regulatory framework. From a public policy perspective, the introduction of any mandated marketplace liability provision will increase marketplace costs (including the capital requirements necessary to operate a marketplace). Changes to the liability framework between dealers and marketplaces will require hundreds of customer and vendor agreements to be renegotiated. Additional regulatory costs would be incurred for administration of these claims. These costs will ultimately be passed through to investors. This in turn will threaten viable competition in Canada and stifle innovation for marketplace services.

It is worth noting that while Aequitas Innovations Inc. are owned in part by certain dealers who have been the most vocal and supportive of a mandated market liability provision; that the membership agreements for both markets exempt these markets from liability

Given the importance of the issues raised by Proposed Amendments, we would like to thank the CSA for the opportunity to respond to the Application and welcome the opportunity to discuss our submission with Staff.

Sincerely,

Chi-X Canada

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