CANADIAN SECURITIES EXCHANGE
The Exchange For Entrepreneurs

September 25, 2014

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Fax : 514-864-6381
consultation-en-cours@lautorite.qc.ca

Re: CSA NOTICE AND REQUEST FOR COMMENT
PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 23-101 *TRADING RULES*

CNSX Markets Inc., which operates the Canadian Securities Exchange (the "CSE"), is pleased to offer its proposals for market reform in Canada in response to the CSA's request for comment on amendments to National Instrument 23-101.

CNSX Markets Inc., and its predecessor corporation, has operated an exchange, recognized by the Ontario Securities Commission, since June, 2004. At the time the exchange was established, it was the first equities exchange to begin operations in Ontario since the Standard Stock and Mining Exchange in the 1920's. The exchange, as of today's date, lists 250 securities from 228 different issuers. All but three of these instruments are uniquely listed on the CSE. In the fall of 2007, through a facility of the exchange branded as "Pure Trading", the CSE launched the first alternative continuous auction market service for trading stocks listed on the Toronto Stock Exchange and the TSX Venture Exchange. Exchange management and staff have extensive experience with policy development, market regulation, trading services, market data and related technologies. As such, we believe that we are well qualified to both comment on the approaches to market reform proposed by the CSA, and offer our own solutions to the issues identified in the discussion paper included in the request for comment.

Our recommended approach is significantly different than that proposed by the CSA. Industry concerns, which are extensively summarized in the request for comment, may be boiled down to a few key points:

1. Forcing investment dealers to connect to all of the visible continuous auction market services through the Order Protection Rule (OPR) has raised trade execution costs in many ways, and

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increased compliance and regulatory risk for investment dealers, without providing a corresponding business benefit.

2. The cost and administrative burden to acquire market information from all of the OPR protected marketplaces is unreasonable, especially compared with other jurisdictions.
3. The burden of maker/taker fees, adopted by most marketplaces to encourage liquidity provision from the high frequency trading community, has fallen heavily on Canadian investment dealers managing trade execution on an agency basis.

To these concerns, we would add a fourth: a lack of transparency for trading activity taking place on non-TMX Group operated marketplaces that has severely hampered the development of a competitive market.

The CSE believes that many of the identified issues can be addressed with the adoption of two key policies:

- **Abolish the Order Protection Rule:** Investment dealers should be the gatekeepers for client access to the markets. An investment dealer's responsibility to achieve best execution will guide its policies and procedures on order handling and trade execution. These policies will determine when or if the dealer will arrange to directly connect to a particular execution venue, or otherwise access liquidity projected into the market by different marketplaces through jitney arrangements or other measures. Concerns that considerable resources have been wasted on the development of smart order routers and related technologies are groundless: these systems are required so long as you have more than one trading venue. For reasons we discuss in detail below, a prescriptive, artificial 5% "order protection threshold" will, we believe, drive behaviours from marketplaces and participants that are unlikely to advance the public interest. It is also likely to discourage innovation in the delivery of new market services.

- **Support the Creation of an Industry Market Data Utility:** the existing information processor addresses a non-existent problem, and fails to address both the unreasonably high cost of real-time market data for end users and the lack of appropriate secondary market transparency in Canada. Vendors such as Thomson Reuters, Bloomberg and many, many others already provide customers with access to consolidated data feed and information display products. The services provided by the TMX IP, which undercut similar offerings from the vendors, appear to be designed to support the co-location, telecommunications and IT services offered by the TMX Group. These services do not address the issues that potential data customers have with the expense and administrative burden to obtain consolidated data services. We are aware of a number of international firms who have chosen to by-pass the Canadian market altogether when they realized the challenges associated with market data acquisition. The CSE believes that efforts should instead be directed at building an industry utility with a mandate to administer the provision of consolidated feed and information display products to consumers under a single contractual, administration and billing mechanism. In simple terms: one agreement, one reporting and administration system, and one fee for access to all of the market information sought by the consumer. These fees would be subject to oversight from the regulators; revenues would be allocated amongst the contributing marketplaces on the basis of an agreed formula. In arriving at this formula, a number of the benchmarks proposed by the CSA in evaluating individual marketplace fees for market data could well be relevant. Our

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proposal on this point was detailed in the submission to the CSA dated February 8, 2013 (see https://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20130208_21-401_carletonr.pdf).

Background

The CSE agrees that the current Order Protection Rule, rules on market data and related transparency, and the maker/taker pricing model for trade execution have increased the costs of operation for investment dealers without providing a corresponding opportunity for these participants to increase business volumes and revenues. Coming at a time when corporate finance advisory mandates are few and far between, and investor appetite for share ownership appears to be waning, the business model for investment dealers in Canada, most especially the independently owned firms, is under tremendous pressure. We also understand the frustration of investors attempting to negotiate the purchase or sale of large volumes of stock without incurring undue market impact cost. The contraction of capital commitment to facilitate block trading that began with decimalization has accelerated as a result of the new market intermediation models.

Identifying who has benefited from the current market structure is not difficult:

- investors purchasing small lots of highly liquid TSX-listed stocks have benefitted from narrower spreads and faster execution speeds
- back office systems providers have benefitted through a large increase in the number of trades required to purchase the same volume of stock; ticketing charges for dealers have soared as a result. Clearing services firms have also benefited from the increased market structure complexity and soaring number of trades
- technology vendors who supply the smart order routers, risk management systems, high performance network components and systems required to manage both regulatory and client obligations in the face of dramatically increasing message traffic
- new market intermediaries who have taken advantage of maker/taker pricing and advanced trading technologies to displace more traditional forms of liquidity provision

The challenge for market participants and the regulators is to find the appropriate balance between a market structure that promotes competition and beneficial innovation, and a system that entrenches significant cost and compliance risk for market participants.

Having carefully considered the matter with the benefit of the input from a number of industry participants, we believe that the measures we propose will achieve the optimum solution.

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 have always understood that, in regulating Canada's securities markets, the CSA have strongly preferred to establish guiding principles, and have avoided imposing prescriptive solutions to particular

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issues. The CSA's proposals in the request for comment are, contrary to this worthy objective, highly prescriptive. They will require that member commissions of the CSA take on significant additional monitoring and oversight of market operations, including the collection and maintenance of statistics and impose considerable costs on marketplace operators. In the case of the proposed threshold, the 5% market share number is based on inputs that cannot be known to dealers and marketplaces. There is no public source that provides accurate data on trades occurring as a result of opening calls, closing calls, intentional crosses, special terms and execution against a market makers book. Without knowing what these data points are, how is a marketplace to know how many shares it must trade in its continuous auction market service in order to qualify for protection under the modified OPR? How is a dealer to know when it might want to consider (pursuant to its best execution obligation) in adjusting its order handling and routing procedures? How often is the CSA going to "reset" the calculation? Is the CSA planning to make adjusted market share information available periodically? Will the regulators even be able to release the constituent share totals (both included and excluded from the calculations) without violating the confidentiality concerns of the marketplaces? How will we account for the significant effort that would have to be expended by dealer, vendor and marketplaces to add or disconnect from various venues that meet or fall below the threshold?

Simply put, public policy should not be formed on the basis of information that cannot be obtained by market participants.

Imposing a threshold of any kind will ensure that marketplaces and their shareholders "do what is required" to exceed that threshold. Many marketplace operators around the world have offered shares in their companies in return for trade executions, or sharply discounted fees (or paid for orders outright) to encourage trading activity and increased market share. We believe that it is a matter of public record that at least one proprietary trading firm received ownership consideration for trading activity on Alpha prior to its integration into the TMX Group. There is no reason to believe that similar means won't be used by the marketplace operators (and prospective operators) to obtain or retain "protected" status. Certain liquidity providers may use their ability to move the needle to demand additional consideration (over and above a maker/taker rebate) to direct flow. Is this activity in the public interest? Does it promote fair and open access to markets? Are these arrangements transparent? Do they promote innovation or efficiency in the delivery of market services? We suggest that the answer to all of these questions is a resounding no.

In excluding share volume arising from crosses, market on open, market on close, and market maker trades, the CSA is acknowledging that there are important structural advantages available to the incumbent marketplaces in preserving market share. These proposed measures do not, however, go nearly far enough to recognize many other distortions that exist. Two operators at present are paying dealers to print crosses. Why? To support their market data sales; and to attract orders from "smart" order routers that do not filter out cross volume when allocating orders on the basis of intra-day traded volume. Does it make sense to count this traded volume, which, although occurring in a continuous auction market setting, has essentially been purchased, as eligible for consideration in the threshold calculations? Similarly, these routers (and related algorithmic trading systems) do not weed out share volumes arising from trades with the RT (MGF or odd-lot). These are two examples of many micro-structure advantages that should fairly be addressed, if the threshold approach is to be adopted. Viewed from another angle, it also demonstrates how difficult it is to come up with a fairly determined threshold level.

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An outright repeal of the Order Protection Rule will instead restore the traditional gatekeeper role to the investment dealers. Guided by their existing best execution obligations to clients, and their own desire to reduce costs and increase operational efficiency, dealers will route orders to destinations that meet their liquidity, pricing and market model needs. We submit that this is the simplest and best way of ensuring that marketplaces offering useful services are rewarded, and those that do not will struggle to find an audience. Healthy competition in the form of attractive pricing and services should be the result.

Underlining the simplicity of the approach, the answers to Questions 2 through 15 become moot if OPR is repealed and the dealer best execution obligation is used to guide dealer access to the markets.

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

For the reasons set out above, we submit that no threshold is appropriate, and that the OPR regime should be abolished.

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?

There is a much more significant issue than order protection when it comes to building investor confidence in the fairness and efficiency of the secondary market trading process. As discussed in the February 8, 2013 comment letter referenced above, no marketplace operator reaches more than ten percent of the audience for real-time Canadian equity market financial information claimed by the TMX Group exchanges. Much of the activity that takes place away from the TMX Group is, as a result, unseen by the vast majority of both the professional and retail investment world. It does not matter that orders are subject to OPR, when the parties involved in a trade occurring away from the TMX Group exchanges can't see either the orders or the resulting trades. As discussed below, we believe that fundamental changes to the market data distribution framework in Canada can address both the transparency and cost issues challenging market participants.

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.

Raising the bar for the introduction of new marketplaces is a clear motive for the imposition of the proposed new rules. We are also concerned that in designing a methodology that includes all eligible Canadian share trading in the denominator, as opposed to looking at the market share of each set of listed stocks on an individual level, makes the threshold even higher for recent and new entrants to meet. Here is what we mean: in the stocks where "short term liquidity providers" are active, experience demonstrates that a material share of trading can be won from the incumbent exchange group. This is not the case for less liquid names traded on the TSX, TSX-V and the CSE. Not segmenting the market by listing exchange (for example) makes the 5% threshold that much more difficult for a new entrant to meet.

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The other issue that the proposal fails to address is the apparent incentive for individual marketplace operators to offer multiple books. The threshold policy does nothing to inhibit a marketplace operator, in particular one who had at least one venue that exceeded the threshold, from launching additional books with different matching algorithms or pricing, to secure marginal market share gains.

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?

This is yet another example of why the CSA approach is flawed in conception. The notion that the Canadian Securities Exchange, which is currently responsible for almost 100% of the daily turnover in its listed companies, would not qualify for protection absent this provision, is risible. The simpler and better approach is to let the dealers perform their gatekeeper role under the existing client best execution standard. With such standards in place, any dealer with an interest in securities listed on the CSE would clearly maintain access to the market and route orders accordingly.

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.

The CSE, in response to industry concerns about the costs of connection to multiple markets and multiple data services, consolidated its trading and market information systems in December, 2013. The cost to connect to the CSE's services was cut in half for the dealer and vendor community, and the transparency of trading activity for CSE-listed securities was dramatically improved. Does it make sense to back this change out, with a resulting increase in costs and reduction in transparency, because the CSE's model doesn't fit with the CSA's views on order protection?

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

For the reasons we have explored above, we do not see the advantages of the approach proposed by the CSA. Instead, we see increased cost, uncertainty, gaming behaviours from marketplaces and participants designed to increase market share, and most concerning of all, an increase in market structure complexity. We submit that we should instead, in our thinking about market structure, to be looking for ways to reduce complexity and cost, while increasing transparency.

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?

This is another example of an issue that goes away if we simply look to the client best execution standard for dealer order handling policies and procedures. Every dealer beginning operations at any

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time will have to have developed its policies and procedures for client best execution prior to launch. In thinking about the implementation times for any new rules, the implementation cycles for the vendors should be taken into account as well.

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

Relying on the client best execution standard would obviate any implementation issues: the standard already exists. To the extent that compliance officers need further guidance on best execution, we suggest that Canadian regulators look to the European Union and the substantial body of work done there on the practical application of the standard in a diverse, multi-market environment. While compliance departments may be looking for a "bright line" that eliminates all regulatory risk associated with the decision of whether or not to connect to a particular marketplace, we suggest that the guide should be the needs, interests and client obligations of a particular dealer. Given that there are always ways for dealers to access liquidity projected on marketplaces to which they are not connected (jitney agreements for one), we suggest that economic self-interest and client service should be the drivers of these decisions, not regulation.

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 this is the route that we go, then it does not make sense to include volumes and market share figures taken from a period of time when the new rules of the road were not known. As a marketplace operator we believe that if it is our interest as an organization to exceed the 5% threshold for stocks listed on non-CSE exchanges, there are a number of measures we would take to increase our share of daily traded volume. While some of these programmes and policies may have been on the drawing board up until now, it seems only fair to do the calculations once all parties have had an opportunity to respond to the new rules of the road. Ironically, the likely impact of these changes would make our services more aligned with the models used by the TMX Group exchanges and Chi-X Canada. It is not appropriate for market share calculations to be taken from a period of time when, for example, the TMX Group exchanges had a maker/taker rebate in place that exceeds the proposed 30 mil limit on liquidity provider rebates. Who knows what impact a forced reduction in the size of the rebate will have on market share numbers? It is also not a fair sample to look at comparative market share numbers given the extreme transparency advantage enjoyed by the incumbent TMX Group exchanges. As discussed in the February 8, 2013 comment letter, the last available public figures from the TMX Group claimed a real-time data customer base an order of magnitude larger than the CSE. We don't believe that any of the other marketplace operators exceed the CSE's exposure. It is not appropriate to measure market share in the manner proposed by the CSA until the transparency gap has been addressed.

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

If it is the correct view that intentionally locking or crossing a market is a deceptive or manipulative trading practice, then a dealer should be required to have policies and procedures in place designed to

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avoid the presentation of locking or crossing orders to any marketplace. Again, this really isn't a new question if we adopt a best execution approach, versus the modified OPR proposed by the CSA.

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

The guidance for dealers would be considerably simplified if they were being held to a best execution standard only.

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

As above.

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

Using the best execution standard alone, instead of the modified “protected market” concept, would ease the transition from the current to the enhanced disclosure sought by the regulators.

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?

Any "changes" to the consolidated data products as suggested would reduce the visibility of otherwise actionable orders in the Canadian marketplace. Is this the direction we really want to go? Our marketplace already suffers from a serious lack of transparency, and the CSA is suggesting that the implementation of these new rules will be facilitated by a further reduction in transparency? We strongly suggest that, and will discuss in detail the means to do so, we should be focused instead on providing data services that both increase the levels of transparency and reduce costs for the end users.

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

How to properly reward professional market makers is a question that probably will never be solved to the satisfaction of all. It seems clear that the present level of rebate for passive orders is incenting a tremendous amount of intermediation in highly liquid TSX-listed stocks and, in particular, ETF's. Although retail investors have benefited from very tight spreads in these names, it is abundantly clear that we are challenged as a market to provide adequate levels of liquidity for institutional traders, and, especially, in less liquid, small cap names. In order to reduce the costs for firms representing client flow in the market, and at a risk to short-term market share, the CSE is currently embarked on a programme to eliminate passive rebates for all trades.

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

If the Proposed Amendments are to be adopted, we believe that the trading fee caps be introduced in conjunction with the new start time for calculating market share for the protection threshold. In other words, we shouldn't start calculating market share for the purposes of determining which markets are protected, until the caps have been introduced.

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

As indicated above, we don't believe that there is a solution to the rebate question that will satisfy all parties. It is our view that we probably overcompensate market making for highly liquid stocks (the indicator being the extreme percentage of "professional" participation in the trading of the ETF's and 60 Index stocks), and under compensate market makers in the less liquid mid- and small cap space. It seems clear that the use of maker/taker models by US market operators was a big reason why US dealers deployed proprietary trading platforms. Dealers who had a high percentage of agency order flow, which tends to be "aggressive", saw their execution costs soar when trading on public markets. Maker/taker and "ticket-based" charges from order management service vendors were the two largest contributors to this increased expense. Rather than press the public market operators to reform their pricing, dealers instead opted out of the public markets altogether. The resulting negative impact on price discovery and book depth in the public markets is one which we clearly need to avoid in Canada. While restrictions on proprietary dealer trading platforms and the client order exposure rule have limited the impact so far in Canada, it appears likely that dealers will continue to search for ways to limit their exposure to "take" fees for client orders. In particular, we are concerned that Canadian dealers are selling client orders to US broker dealers for handling and execution in the United States, either on a listed market (or proprietary facility) for inter-listed names, or on the over the counter markets. If execution costs for the active side of a trade can be reduced, then the incentive to send orders to the US for execution will be sharply reduced.

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 conversations on this issue, we have heard it proposed that non-inter-listed names only be used for the purpose of a pilot study. The thinking goes that unilaterally implementing a pilot programme in an inter-listed name would result in a serious loss of market share for Canada in the likely event that spreads widened and volumes dropped for the stock(s) in the study. This view ignores the rapidly developing practice of US market makers quoting the non-inter-listed stocks on US over the counter facilities. Substantial volumes in some Canadian stocks are now trading south of the border, encouraged in part, by the sale of flow from Canadian dealers to US wholesale firms. Unfortunately, as a result, we can expect to see the same impact on trading in non-inter-listed stocks: if the Canadian spread widens, the case for executing an order in the US becomes that much more compelling. We

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should instead be focused on measures that increase the attractiveness of Canadian public market services.

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

As discussed above, there are serious issues with including any category of security in a pilot programme.

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?

As discussed above, we do not believe that a pilot programme is advisable.

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

As above.

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?

For the vast majority of Canadian stocks, some form of compensation (over and above the opportunity to earn the spread) is required to support market maker participation. Marketplace rebates are one such form of compensation; enhanced participation privileges and monthly subsidies paid directly from the issuer are two other means used to encourage better market quality. Although the CSE is moving away from the maker/taker model, we believe that a prohibition of rebates, with various exceptions that will get implemented over the years, is an approach that will yield complexity and confusion.

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.

We have a number of concerns about the current state of market data, and with the proposals set out by the CSA to address them:

- By any measure, real time data from Canada's equity market costs too much, and is far too difficult and complicated for dealers and investors to obtain.
- the expense and difficulty of obtaining and managing this data has led to a serious transparency deficit: after all this time, most professional advisors and investors in Canada

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have access only to market data services provided by the TMX Group exchanges. The current policy is a failure.

- One factor not raised in the CSA paper is the contribution of fees and charges charged by intermediaries in connection with market data delivery. A study by the UK-based market data consultancy Oxera (www.oxera.com see "Pricing of Market Data Services" February 2014 at p. 5) found that out of every dollar spent on market data by a European end user customer, somewhere between 8 and 15 cents only was accounted for by the exchange fees. Other fees (vendor charges, telecommunications fees, and hardware and software costs) made up the rest. We suspect that this figure would be similar in the Canadian marketplace. The reality is that regulating exchange fees as proposed by the CSA will not result in the significant reduction in charges hoped for by the consumer market.
- There is another fly in the ointment of the approach proposed by the CSA. While the information is not public, we are prepared to make a well educated guess that the TMX marketplaces charge at least 85% of all market data fees assessed by Canadian marketplace operators. Three out of their four books are currently fee liable: TSX, TSX-V, and Alpha. The CSA has already provided an opinion that the fees charged by the TSX and the TSX-V are "reasonable"[1]. That leaves only 15% of the actual vendor and end user spend subject to change under the approach proposed by the CSA. The result will be a great deal of regulation effort, compliance activity from the marketplaces and no material cost reduction benefit to the end users suffering under the burden of Canada's unreasonable market data fees.
- From the CSE's perspective, and we believe this to be the case for the other "alternative" marketplace operators, a significant chunk of current market data revenues are earned from non-dealer sources, in particular from the international buy- and sell-side.
- Specifically with respect to the benchmarks proposed, there is considerable US evidence to the effect that marketplace operators and their supporters will game the benchmarks to gain maximum advantage for their data fees. We appreciate the difficulty of establishing benchmarks that adequately recognize a marketplace's contribution to price discovery, without providing incentives for behaviours negatively affect the public interest.

We will again propose a completely different approach, one that **will** reduce end user costs and dramatically improve the transparency of Canada's equity markets. The plan, which can be described as "Consolidation without a SIP", looks like this:

- The industry (regulators, marketplace operators, and consumers) will collaborate on the creation of a not for profit company ("Marketdataco") to administer the provision of consolidated market data products to vendors and end users.
- Each marketplace will appoint Marketdataco as its agent for licensing vendor and end user access to its market data, as a component of consolidated data products to be created and distributed by the commercial data vendors.
- The vendor and end user fees, and customer agreements, imposed by Marketdataco will be subject to regulation.
- Marketdataco will not operate any technical consolidation facilities. Instead, customers looking to obtain consolidated feeds and other products would contract with the vendors, or directly connect to each of the individual marketplaces if they were looking for a bespoke solution. The

[1] See CSA STAFF CONSULTATION PAPER 21-401 REAL-TIME MARKET DATA FEES on page 1.

TMX IP services are redundant, and have been since inception, with services provided by all of the vendors operating in the Canadian market. If the TMX sees commercial value in continuing to provide a single hub, then they may do so on the same basis as the commercial vendors.

- Marketdataco will determine the business model for end user pricing and usage policies, eliminating the current inconsistency among the various policies on "units of count", "pro vs. non-pre", "black box" and other contentious issues. It will operate the billing and reporting function, with the vendors and end users connected through the use of industry administrative services such as that deployed by NYSE or the VARS system operated by TCB Data Systems. The benefit to the industry is that all of the data could be accessed for one fee, with one contract and one supporting administrative process.
- Revenues, once the modest operating costs of Marketdataco had been recouped, would be allocated amongst the contributing markets according to a formula that would ideally leave each participant equally unhappy. Although much criticism has been levied against the allocation methodologies used by the Consolidated Tape Association in the US for revenue sharing, their current model is a result of more than 30 years' experience and hard bargaining. It would not be a bad place to start, and appears to have informed the CSA in developing some of the benchmarks proposed in evaluating the relative value of market data.
- Marketdataco would oversee products for each set of listed stocks: at present, one each for the TSX, TSX-V and CSE. Options and futures data could be consolidated in the event that competitors to the ME emerge.

A number of questions would have to be addressed in creating and overseeing the development of Marketdataco:

- What benchmarks should be applied to determine the price for each consolidated display product?
- Should Marketdataco be the exclusive licensor of consolidated products, or should marketplaces be able to contract directly with vendors for individual data products. In the US, for example, NYSE, NASDAQ and BATS have all introduced "direct" products that contain each exchange's data only, at a price point significantly lower than the consolidated product. Is this appropriate?
- What is the appropriate mechanism for adding new marketplaces to the system following the launch of Marketdataco?

By assisting with the implementation and oversight of Marketdataco, the regulators would address the exchange component of end users' market data costs, and at the same time, deal with the transparency deficit. Best of all, the industry would be responsible for the ongoing operation of the facility. While the CSA commissions may feel that they lack the regulatory competence to impose this solution on the industry, the CSE intends to obtain the support of as many of the necessary parties as possible to turn this plan into reality.

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?

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There are a number of issues around the provision of market data to non-professional subscribers that illustrate the folly of continuing the current model:

- The marketplaces don't agree on what constitutes a "non-pro". End users may have a different status depending on which marketplace they are reporting to, and are required to track and account for these differences. Get it wrong, and the end user is liable for audit fees and back charges.
- Pricing for non-pro services varies enormously among the marketplaces.
- It is not reasonable to expect non-pro data customers to deal with all of the different marketplace providers in order to receive all of the market data sources required to have a full picture of the market. As a result, customers have gravitated towards the incumbent, harming both transparency and the development of a more competitive market.

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.

As above.

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?

If the CSE is forced to back out its consolidation of trading and market information access as a result of the implementation of the Proposed Approach, the immediate result will be a dramatic reduction in the transparency and trading access to the CSE-listed securities market. Imposing increased connectivity costs for market data and order execution systems will reduce participation in the markets, harming price discovery, liquidity and capital formation for the CSE's listed companies. We cannot stress this point strongly enough.

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.

No. We see the proposed approach achieving the opposite: a decrease in competition. Only the TMX Group exchanges and one Chi-X Canada book make the grade; how is that supporting a competitive environment? The only encouragement of innovation will be in different ways to game the thresholds to attain or retain protected status and maximized market data revenues under the rules. Launching new market services will be severely curtailed; something that unfortunately appears to be at the heart of the measures proposed by the CSA.

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?

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Membership and connectivity fees are already regulated under the "fair access" principles. Changes to these fees (even reductions!) have to be justified to the responsible regulator. We do not see what purpose additional regulatory processes would serve, or on what further basis the fees would be regulated.

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 have a number of thoughts on the issues related to marketplace liability:

- Regulators have the opportunity to address an inappropriate allocation of risk (as between the marketplace and its dealer customer) under the fair access principles under the respective securities acts and instruments.
- There is no guarantee that the liability allocation provisions in the marketplace access agreements are enforceable; it is possible that dealers are presently in a position to sue a marketplace for errors and omissions notwithstanding the language in the current agreements.
- There is no evidence that the risk allocation set out in most marketplace agreements either encourages or incents reckless behaviour on the part of marketplaces in the introduction of new services or in the management of their day to day operations. We believe that all marketplace operators, fearful of the negative consequences of service interruptions and client losses as a result of errors and omissions, conduct their business in a way to reduce risk wherever possible.

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.

Our comments on all of the proposed metrics are the same. The CSA is making a fundamental error in assuming that all marketplaces are competing on an equal basis in assessing their contribution to price discovery, volume traded and so on. They are not. The incumbent exchanges have an overwhelming advantage in the transparency of their markets. Bids and offers booked on the TMX Group exchanges reach an audience ten times larger than that of its competitors. This advantage skews the competitive balance, especially for less liquid securities where the rate of participation for "natural" liquidity is significantly greater for the S&P/TSX 60 names and related ETF's. We believe that it would be appropriate to study the use of these measures in a different context: once a level playing field has been established for access to market data services through Marketdataco, then a means to allocate resulting revenues to the contributing marketplaces has to be developed. As discussed earlier, care has to be taken not to incent negative behaviors by the marketplaces designed solely to increase their share of the data revenues. Although complicated, the US Consolidated Tape Association system would be a good place to start a review of the appropriate mechanism for allocating revenues.

Comparing relative marketplace contribution to price discovery at this point, when the transparency gulf is so enormous, is simply not a fair means of determining an appropriate price for market data services.

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Instead, we should be looking to establish a service and absolute price that addresses the transparency and cost concerns, and then allocate the revenues from the consolidated services amongst the contributing marketplaces.

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.

As 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.

As above.

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.

As above

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.

As above.

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

We don't believe that any of the methods proposed are appropriate in the context of the proposals.

Question 37:
Please provide your views on the reasonableness of the two approaches for establishing an appropriate reference amount for data fees to be used in applying the data fee review methodology?

The CSA should be concerning itself with closing the transparency gap amongst the different marketplaces, and in addressing the total cost of the data to the end user customer. Regulating the

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fees of the individual marketplaces, as discussed in our response to question 24, will achieve neither goal.

Question 38:
What other options should we consider for identifying an appropriate reference amount? Please provide details.

As above.

Question 39:
How frequently should any selected reference amount for data fees be reviewed for their continued usefulness?

If the Marketdataco system is implemented, the CSA commissions would not have to go through the tiresome process of responding to possible changes to market data fees brought on by new market entrants or by relative changes to traded volumes, quote traffic, time on the bid/ask, or any other measure. Instead, the fees for each consolidated service could be set at a level that represents a significant discount from current price levels for end users, leaving the marketplaces to establish (with a likely assist from the regulators) the principles under which the revenues would be shared. This approach would save a tremendous amount of time, scarce regulation resources, and provide a predictable commercial model for providers and consumers of Canadian market data services.

In closing, we thank the members of the Canadian Securities Administrators for the opportunity to respond to the request comment on important reforms to Canadian equity market structure. While we may not agree with many of the specific approaches proposed, we share concerns that our markets have to become more cost effective for all users, as well as transparent, more competitive and fair. The Canadian Securities Exchange is committed to working with our partners in the industry to finding solutions that will, ultimately, enhance the capital formation process for businesses looking to access the markets for public capital in Canada.

We would be pleased to address any further comments or questions from the CSA members on these critical market structure issues.

Respectfully submitted,

Richard Carleton
Chief Executive Officer

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