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September 26, 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
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

c/o
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Dear Mesdames and Sirs,

Re: Proposed Amendments to National Instrument 23-101 *Trading Rules* ("NI 23-101") and Companion Policy 23-101 ("23-101 CP") (together, the "Proposed Amendments")

Please see below our response to the request for comment set out in the Notice describing the Proposed Amendments (the "Notice") published by the Canadian Securities Administrators ("CSA"). We thank the CSA for its careful analysis of these important issues facing the securities industry and commend the attempt to deal with these issues in a practical way.

As an organization that has filed an application for exchange status, Aequitas Neo Exchange Inc. (Aequitas) is in a unique position to provide feedback, particularly considering that questions were raised in the regulatory notice accompanying our filing about application of the current Order Protection Rule ("OPR") as well as the Proposed Amendments to Aequitas. Out of the sixty comment letters the OSC received in response to our application, a large majority of those mentioning it supported the application of OPR to both of our proposed displayed books. What we can extrapolate from these comment letters is that stakeholders generally believe in order protection and that when they feel that a marketplace can bring value, they consider it important for orders placed on it to be protected.

I. General observations

There is little dispute that regulation should not drive commercial behaviour in such a way as to support business activities that would not survive without it. The "captive consumer" issue is an unfortunate by-product of both OPR and the evolution of our markets. We are, however, concerned that, despite the care taken to arrive at the proposed solutions, they will not meet the stated objectives and that the key proposal – the 5% threshold for order protection – will instead exacerbate the problems the CSA is seeking to solve. Other parts of the proposal regarding market data fees, trading fee caps and the maker/taker study are all steps in the right direction, but they do little to address the issue that lies beneath several of the competitive barriers in our markets and what forms the cornerstone of any best execution policy: the lack of consolidated market data for all users at an economically acceptable price.

Aequitas' general comments on what we see as the core issues are set out immediately below. Responses to the questions in the Notice follow these comments.

1. *Best execution and a partial OPR environment*

The uncertainties around application of best execution is one of the most compelling reasons against the adoption of a threshold as the first step in addressing the targeted problems. Best execution has been in place for much longer than OPR. Since OPR was adopted, however, there have been questions about how they interrelate. Best execution, as a principles-based obligation, is not an unreasonable alternative to OPR, but a market that is 100% subject to best execution and only partially subject to OPR will open up a new set of costs and complexity. Investments would have to be made in new smart order routing technology and execution algorithms in order to meaningfully balance OPR and best execution, creating challenges for intermediaries in appropriately using unprotected marketplaces for the benefit of clients without violating OPR.

2. *Impact of the threshold on costs and captive consumers*

Creating two regulatory tiers of marketplaces, in order to force smaller ones to be "more competitive" and/or ensure new entrants have a lot of funding and proprietary (aka mobile) flow to sustain a long path to protected status, seems to only makes sense if: (a) the existing under-5%ers are in fact not innovating, (b) the costs associated with such marketplaces are significant, and (c) there is no benefit in having new entrants that are not supported by proprietary flow. However, absent from the information from industry consultations were details of the costs resulting from the current application of OPR. In the comments received on our application for recognition, some commenters maintained that connecting to a new marketplace was prohibitively expensive and others that the costs were minimal. We expect that the answer is somewhere in between, but suggest that before making changes that may have far-reaching implications, the costs should be validated. This would allow the related issues to be met head on – dealing with them directly through overall limits and/or thresholds, instead of attempting to do so indirectly through a market structure change. We also believe that marketplaces could play an important role to in reducing connection costs by approaching system architecture in as user-friendly a way as possible.

Another issue with the proposed threshold is the likelihood that it could lead to unintended and increased costs to the industry. By creating an environment with both protected and unprotected markets, dealers would have additional complexity to take into account. One example would be that there would be two

types of consolidated market data feeds, one with only protected marketplaces' data and one with data from all marketplaces. Changes would be required all the way up the distribution chain to the retail investor.

It is difficult to see how, in any of these scenarios, the central concern of captive consumers is resolved. This is highlighted by the fact that the most costly industry initiative of the past few years was the integration of a new trading system of a marketplace that would be certain to be protected. Since there will be protected marketplaces so long as there is OPR, then there will be "captive" consumers, unless other solutions are put into effect.

3. *Impact of non-consolidated indicative market data on costs, best execution and captive consumers*

Although it is touched upon in the Notice, there is very little analysis regarding non-consolidated indicative data. Although it is, of course, critical that data available for trading is reasonably-priced and accessible, these issues can be dealt with through fee limits and reviews. The issues around indicative data are less obvious and more difficult to address, as it has always been viewed as a commercial issue. Where we believe a regulatory issue has emerged is in the role indicative data is playing in reinforcing market dominance and on the ability to ensure best execution. Further, it is an element of the captive consumer issue that is left unaddressed by the Proposed Amendments.

The vast majority of retail investors and their investment advisors, as well as many institutional investors, receive indicative data only from the TSX and TSX Venture Exchange. Given that this is these parties' view of the markets, they will raise concerns when an order is placed on another marketplace because they can't see it, and alternatively will not complain if they miss something elsewhere, for the same reason. This lack of transparency puts the overall concept of best execution at risk.

As noted above, while indicative data remains a monopoly product, it will have monopoly pricing. This is raised in the Notice, but as a next step. We believe it is a critical first step, not only in addressing the captive consumer issue but also for providing the necessary tools for monitoring of best execution by retail investors and advisors. Before considering a move to a structure where best execution is brought to the forefront, instead of mixed together with order protection, there needs to be good quality, low cost indicative data to allow all those who rely on indicative data to easily understand how their orders are being treated.

4. *Role of signals from regulators*

Multiple markets and new products and services require an evolution on everyone's part – the CSA, IIROC, dealers, buy-side institutions, retail clients, vendors and the marketplaces themselves. It is inevitable that the industry will evolve more quickly than regulation. However, there has been an unintended bias to the status quo. The most recent example of this is in the IIROC materials published in association with the Proposed Amendments. In Notice 14-0124, the proposed guidance states that to meet client priority obligations, a dealer would be prohibited from putting client orders on an unprotected marketplace at the same time it is placing principal orders on a protected one, because "…there is a probability that an order at a specific price may execute on a protected marketplace before an order on an unprotected marketplace". The proposed guidance does not allow a dealer to determine that it is appropriate to send the client order after analyzing fill rates and being satisfied that sending the order there is consistent with best execution. It simply assumes that unprotected marketplaces will be inferior in all securities at all

times. It would be very difficult for a dealer to send client orders to an unprotected marketplace, whether or not it is also trading on a proprietary basis, knowing this view.

In conclusion, while we agree that the right issues have been raised, we submit that the following would be a preferable approach (as further described in our response to the questions set out in the Notice):

1. Focus on ensuring market data is fully consolidated and fairly priced.
2. Implement fee caps.
3. Carry out the maker-taker fee pilot, taking care to consider the impact of going forward independently of the U.S. or delaying until it can be done in concert.
4. Return to the OPR review, with two main alternatives: (a) validating it and dealing with any remaining captive consumer issues directly, or (b) removing it entirely and relying on best execution.

II. Responses to specific questions

Set out below are Aequitas' responses to the questions set out in the Notice.

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.

Although we do not believe that the threshold approach should be pursued, if the CSA proceeds in implementing it, we agree that trades resulting from continuous auction activity should be included, excluding crosses, dark orders, opening and closing calls and special terms orders from the calculations.

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

Given the length of time proposed for a marketplace to remain unprotected once it reaches that status, 5% would appear to be very high. Even with a 2-4.9% market share it is possible for a marketplace to be the primary location for trading certain securities, and best execution would dictate that orders be sent there, reducing or eliminating the purpose of the threshold.

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?

We do not agree with this as an appropriate presumption. The benefits of protection are by nature subjective. If you are in the 10-15% that is not protected, you will be as aware or unaware of any unfairness – and impacted by it – as you would be in the current 100%-protected regime.

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.**

As noted above, with an underlying regulatory theme that unprotected marketplaces will be assumed to produce inferior fills, dealers will be unable to send client orders without specific instructions to do so. This means that, without either significant proprietary trading support (most likely from high frequency trading firms and desks) or strong market making support (such as that which we are hoping to have), new entrants will have difficulties succeeding.

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?**

It would be a particularly unfair and anti-competitive result if the exchange bearing all costs associated with listings were not to be protected for trading, but it would have an impact on the amount of relief provided to captive consumers, as all the upfront costs would still have to be incurred.

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 CSA could consider only protecting a marketplace for its listed securities, and require unbundling, but as noted above it appears that much of the cost causing concern relates to connecting to a new venue so, again, the value of setting the threshold would be reduced.

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

It is our view that a review should occur more frequently than annually. A new entrant achieving the threshold in a few months would not be protected until it was operational for at least 15 months. Similarly, it would seem unfair and contrary to the purpose of OPR if an unprotected market's share was to increase significantly and a protected market's was to decrease, but their respective statuses continued for over a year.

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 should, perhaps, be dealt with similarly to the approach IIROC took in imposing OPR initially, i.e. providing some flexibility so long as the dealer's approach is reasonable in its specific circumstances.

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

The big issues, in addition to dealer costs for re-working smart order routers and more market data costs, are the adoption of dealer and advisor compliance procedures for dealing with both protected and unprotected marketplaces, and the creation of a new regime at IIROC for monitoring and enforcing best execution. Further, an approach that may result in connecting, disconnecting and re-connecting over time appears to have inherent implementation issues. Instead of reducing costs, this approach could increase them. This again underscores the need to have better data on costs – if the main benefit of including a threshold would be to make it more difficult to add new marketplaces, then applying it over time to existing marketplaces appears counterproductive. We believe that "captive consumer" costs should be dealt with directly through fee caps and other measures, instead of dealing with the costs indirectly through OPR amendments which, as significant market structure changes, are certain to have unintended consequences.

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?

The nature of the Proposed Amendments suggests that no matter what period is chosen, it will be challenging for some. If it is long, it creates uncertainty and if too short it could cause confusion and impact trading quality among both protected and soon-to-be-unprotected marketplaces.

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

We do not believe that the proposed approach to locked and crossed markets is necessary because, under the assumptions underlying the Proposed Amendments, allowing orders on an unprotected market to cross or lock another marketplace, or even trade through, should not have a negative impact. This is primarily due to the logic that, if one of the aims of having unprotected marketplaces is to reduce data costs, market participants will be able to choose not to consume data from unprotected marketplaces, which means they will not see the locked or crossed markets. We raise fairness concerns about the notion of imposing any such obligations, including OPR compliance, on marketplaces that are themselves unprotected. The dealers that chose to send orders to an unprotected marketplace would be in the best position to be responsible for locked/crossed markets and OPR, and new marketplaces should not have to incur related compliance costs until such a time as they are protected themselves.

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

Dealers are in the best position to provide responses to this question, but we would suggest that guidance would be needed on how dealers and advisers would meaningfully analyse the trading activity on unprotected marketplaces without subscribing for their data in order to assess "…the frequency at which a better priced order is available on a marketplace, size and depth of quotes, traded volumes, the potential for market impact, and market share."

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

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

Regardless of whether the Proposed Amendments are adopted, the proposed dealer disclosure should be put in place to help put clients in a position to assess best execution. One additional disclosure could be to identify practices regarding routing of orders outside of Canada, not just the disclosure of any such routing. As for the transition period, we feel that dealers are in a better position to comment on that.

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?

Since all trading data would be needed for best execution purposes and a subset for OPR, the IP will need to include everything but also provide different views. This will be a minor challenge for the IP to determine how best to offer the various displays. The bigger implementation challenge will be in moving from the current billing model, which is a pass-through. The IP does not provide data without the marketplaces first permissioning the users. A change in this practice would be required and new processes and agreements would have to be developed. This is in addition to the extensive work that would be required by market data vendors and their counterparties in facilitating the additional products required to meet OPR-best execution versus best execution-only obligations.

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

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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?

We are advocates of reliance on competition as a constraint on trading fees but believe that the maker / taker fee model hinders effective fee competition. We are in support of the proposed caps as a first step in addressing maker / taker fee model issues. We have no comment on the transition period.

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

We believe that payment of rebates is a key issue requiring regulatory attention. Many current market behaviours that are causing concern for investors tie back to the maker-taker model. While there is data that shows that the presence of informal market makers has increased volumes and narrowed spreads, there also data that it has added to intra-day volatility and unnecessary intermediation in highly liquid securities, while leaving less liquid securities unsupported.

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?**

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

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?**

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

Our main comment on the pilot study is that payment of rebates is one of the largest factors driving behaviours in our markets, and before proceeding with a change to OPR, the pilot study should proceed. By virtue of OPR's central role in our current market structure, the proposed thresholds would have significant, unintended consequences, while the pilot study can be crafted to reduce any foreseen impact and changed or terminated if anything unforeseen arises. We do, however, acknowledge the challenge relating to timing the pilot without a similar pilot in the U.S as that could significantly impact the trading pattern of interlisted stocks and hence remove the ability to draw any meaningful conclusions from the data. Perhaps the place to start would be ETFs?

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?**

The current trading fee models with rebates versus active fees have caused challenges relating to alignment of best execution and OPR. There does not appear to be a good reason to treat market makers differently than other traders from a rebate perspective.

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 recognize that a considerable amount of time was spent analyzing the factors that should be considered; however, as noted in our general comments, we believe the proposal fails to address the main issue which, in our opinion, is the access for all users to consolidated data that is not cost-prohibitive. One important step would be to re-define "data" in market data agreements. Also, we suggest that current fees should not be considered as an acceptable base for the calculations used in the methodology, described in the Notice as the "domestic reference". Any approach to rationalizing market data costs should leave open the opportunity for competition to play a role, in tandem with any regulatory limits on public feeds.

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?

As noted above, we believe that solutions for addressing the issue of access to a consolidated data feed that is not cost-prohibitive should include non-professional market data fees. Non-consolidated indicative data is one of the largest constraints on competition due to the lack of transparency of orders and trades on all marketplaces other than TSX and TSX Venture for the vast majority of users. For retail clients and their advisors to have any opportunity to evaluate best execution, they need reasonably-priced consolidated data.

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 indicated in our earlier responses, we are not supportive of the proposal to modify OPR by introducing a threshold, as we believe it would have unintended consequences. However, the caps for trading fees would help provide some relief and the methodology for dealing with market data fees is a positive step, but one which needs further consideration as observed above. We feel that a pilot study on rebates will provide important feedback, and help determine alternatives. And, while we continue to believe that the right way to impact costs is through competition, we empathize with industry participants, who are under a lot of pressure, requiring some cost relief. However, instead of dealing with these costs through OPR changes, which at the end of the day will negatively impact investors, our suggestion is that the regulators deal with some of these costs in a more direct manner. A threshold approach could be used to constrain certain fees, whereby marketplaces under a threshold are limited to what they can charge for, or constrained entirely for certain services until they gain more market share. This would accomplish the same goals, more directly addressing the captive consumer issue, without impacting a core market structure framework and without creating an environment that would stifle marketplace competition.

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

The impact would depend on whether the amendments were applied to our displayed books prior to implementation. Our business plan is not reliant on order protection - and this view was reinforced by the comment letters received on our application – but we acknowledge that it would likely increase the costs of becoming operational. Even without any of the expected outcomes, such as not receiving much, if any, retail flow due to dealer concerns that it will be viewed as a violation of best execution or client priority, the uncertainty of being the first unprotected marketplace would have some impact.

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.

As noted in our general comments, the Proposed Approach would make it extremely difficult to launch a new marketplace in Canada. Therefore, competition would need to come from existing entities. We cannot see how the Proposed Approach will do anything other than reinforce the dominant position of a few marketplaces, which has never been a recipe for innovation.

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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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?**

With or without a protection threshold, all costs need to be quantified and, where necessary, addressed. As an example, consideration should be given to the fact that it is currently possible for dealers to control their membership fees by using other dealers to access marketplaces they do not wish to access directly. That said, marketplaces should be held accountable for their fees. Are their solutions designed to ensure the connectivity costs are reasonable? Are their fees driven by costs or leveraging the fact consumers are captive?

The marketplace liability issue would most effectively be solved by a more competitive environment whereby users could hold a marketplace accountable by using or not using its services. We are, however, supportive of some form of mechanism that would put a financial liability on marketplaces with a poor operational track record. Before implementing such a mechanism we believe a comprehensive review should be undertaken, to ensure that the delineation of responsibilities is well defined, and that penalties are adequately aligned with the nature of the issues and are meaningful, considering the profile of the marketplace.

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.**

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.**

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.**

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.**

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.**

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

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?**

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

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

As set out above we are of the opinion that a root cause of many of the current issues is the lack of availability of consolidated data at an affordable price, which is not ultimately addressed by the approach to market data pricing discipline in the Proposed Amendments. Facilitating meaningful competition in market data provision would require breaking the current near-monopoly and immediately addressing the high non-professional fees, at which point competitive forces would start putting downward pressure on professional fees as well. It is our opinion that this is something that should be addressed first as it would likely negate the need to regulate data fees.

As for the specific questions regarding the proposed metrics, we feel those are best answered by the market participants that contribute to price discovery as they are in the best position to evaluate the relative value of market data. We would however like to reiterate our position that we believe that "data" needs to be re-defined and that the "domestic reference", as described in the Notice, is not an acceptable base.

We again thank the CSA for the opportunity to comment on these important considerations.

Yours truly,

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