July 6, 2016

The Secretary, Ontario Securities Commission
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comments@osc.gov.on.ca

and

Madame Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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Re: CSA Notice and Request for Comment Proposed Amendments to National Instrument 23-101 Trading Rules ("Proposed Amendments")

Dear Sirs/Mesdames:

Nasdaq CXC Limited ("Nasdaq CXC" or "we") welcomes the opportunity to provide comments on the Proposed Amendments.

The Canadian Securities Administrators ("CSA") outlined certain concerns expressed by marketplace participants in its review of the Order Protection Rule in 2014 ("OPR Review").[1] As a result of these concerns, a fee cap of $0.0030 was proposed and recently approved in April 2016 for active trading fees for exchange traded securities one dollar and over. Proposed Amendments serve to extend the limitation placed on marketplace active fees where active fees for Non Inter-listed Securities[2] are proposed to be capped at $0.0017 for securities one dollar and above.

While we understand the policy objective of the CSA is to lower costs for participants with larger active-passive trading ratios within an Order Protection Rule ("OPR") regime, we caution the CSA on the speed of its approach.[3] We believe that the proposed $0.0017 fee cap may be too aggressive and could result in an unintentional deterioration of market quality and liquidity on the securities impacted. This in turn could potentially threaten the Canadian listings market as Canadian issuers will have less incentive to keep their existing listings in Canada and new issuers will have more incentive to choose to list in alternative jurisdictions. Instead, we suggest that an iterative approach is taken starting with a more conservative fee cap of $0.0023. This will significantly lower the level of fees permitted by regulation today, while also enabling the CSA to monitor and assess the need for further fee decreases. Given the risk to market quality we request that the CSA clearly articulate its goals as well as its concerns (such as

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[1] *Canadian Securities Administrators Notice and Request For Comment Proposed Amendments to National Instrument 23-101 Trading Rules* published on May 15, 2014 at (2014) 37 OSCB 4879-4888.
[2] Non Inter-listed Securities are defined in Proposed Amendments to be securities that are listed on a Canadian exchange that are not listed on a U.S exchange.
[3] *Canadian Securities Administrators Notice of Amendments to National Instrument 23-101 Trading Rules* published on April 7, 2016 at (2016) 39 OSCB 3341.

impact to market quality) for such Proposed Amendments so that the program's success can be measured. Without clearly stated objectives, the success or failure of the program cannot be determined.

LOWERING FEES MAY THREATEN MARKET QUALITY

Given that the predominant pricing model supported today by marketplaces is the traditional maker-taker (which provides a rebate to the passive side of a trade while charging a fee to the active side), lowering the active fee charged for any group of securities will result in a commensurate decrease in the rebate for passive orders. A lower rebate in turn poses a risk to market quality as spreads may become wider and available liquidity may decrease due to the increased economic risk borne by market makers to quote visible orders. In fact, a similar risk is acknowledged by the CSA in Proposed Amendments where the rationale for not imposing a fee cap on Inter-Listed Securities[4] at this time, is cited to be that, due to the sensitivity of rebates by liquidity providers, a shift of liquidity to the U.S. may result if the rebate in Canada is lowered compared to that in the U.S.[5]

The strategy of a traditional market maker is to post bids and offers for a security with the objective of capturing the bid-ask spread. Given short term imbalances in demand and supply, the result of the majority of these trades is to break even, or sell at the price level that shares were first purchased, or buy at the price level that shares were first sold. In order to make an overall profit using this strategy many small profits are required to be made in order to compensate for a few large loses. Passive rebates provided by marketplaces act as an economic incentive for market makers to take on risk by displaying trading interest and to make markets more aggressively. This incentive, coupled with competitive pressure among market makers, results in tighter spreads and larger sized posted orders which are available to marketable active orders. Economically, the higher the rebate provided – the greater risk that can be taken by a market maker to make better markets and tighter spreads.

Nasdaq Inc.'s (Nasdaq) experience in the U.S. from unilaterally lowering access fees in fourteen stocks during the first four months of 2015 may be instructive (the "Fee Experiment"). During the Fee Experiment Nasdaq reduced access fees and lowered rebates for one of the Nasdaq owned-markets in the U.S. As a result of the Fee Experiment, the Nasdaq market lost liquidity and market share as fee sensitive market makers shifted their market making activity to other U.S. markets which continued to offer rebates and access fees similar to those offered by Nasdaq before the Fee Experiment. There was no overall change in market quality. However, whereas in the U.S. market makers were able to move their activity to other venues with higher rebates, in Canada no such alternatives will be available. Therefore it is likely that some market makers may exit market making entirely in the impacted securities which could directly impact market quality for these securities.

A similar loss in market share was experienced by Nasdaq CXC when it lowered its fees (and related rebates) for ETF securities in June 1, 2015 to levels significantly below those of the TSX ($0.0017 vs. $0.0023). Instead of seeing more active orders prioritizing Nasdaq CXC quotes ahead of other markets and leading to an increase in market share, a decrease in market share was observed instead. This serves as evidence that for participants trading these securities that the amount of posted liquidity on a single market has more value than the active fees charged on that market to trade. Consequently, in order to remain competitive, Nasdaq CXC was forced to shift the level of our fee and rebate for ETFs closer to our original level in October 2015. Given this outcome, it stands that lowering the fee cap risks lessening competition as alternative venues will lose a valuable tool to compete with the TSX.

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[4] Inter-listed Securities are defined in Proposed Amendments to be securities that are listed on both a Canadian and a U.S. exchange.
[5] *Canadian Securities Administrators Notice of Amendments to National Instrument 23-101 Trading Rules* published on April 7, 2016 at (2016) 39 OSCB 3344.

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ADDITIONAL RISK FOR ILLIQUID SECURITIES

The incentive of a passive rebate for a market maker to make a market is closely related to the liquidity profile of the security. All things considered equal, a market maker will require a higher rebate to make a market on an illiquid name compared to a liquid name due to the additional risk of unwinding a position. Apart from traditional market maker activity, a security that attracts more long term investors and trading strategies will require less incentive for liquidity provision. Other factors that also contribute to the liquidity of a security are: whether it is included in an index (and represented in the calculation of index related products) and whether or not the security is inter-listed.

This poses a problem for Proposed Amendments. The lower active fee cap being proposed for Non Inter-listed Securities will result in a lower rebate provided for a segment of securities that requires a higher rebate compared to Inter-listed Securities. The majority of securities captured under Proposed Amendments have smaller market capitalizations. They are not constituents of Canada's major indices and are not inter-listed in the U.S. The combination of these characteristics results in liquidity profiles that are inferior to those inter-listed names where an active fee cap of $0.0030 is permitted. This is reflected in a 34% lower average daily volume for Non Inter-listed securities compared to Inter-listed securities.[6] Although we do not object to a lower fee cap being introduced, we do note the risk to market quality may be accentuated for this segment of securities.

RISK TO CANADIAN ISSUERS

We are concerned that there will be a threat to the Canadian listings market should any negative impact to market quality and liquidity result from Proposed Amendments. Some of the main considerations for any issuer when deciding where to list are the liquidity profile of the listing exchange and the jurisdiction where the exchange operates. Markets that are less liquid are less desirable to any issuer as an active secondary market facilitates the opening and closing of positions and influences the coverage of the security by analysts and the level of awareness about the company by the public. Any regulatory action that threatens liquidity provision in turn will remove the incentive for a Canadian based company to list in Canada. Should issuers observe any loss of liquidity on their securities due to Proposed Amendments they may be incentivized to move their existing Canadian listings to other jurisdictions. Similarly, new issuers may find alternative jurisdictions more attractive to choose to initially list.

Canada cannot afford any additional challenges to its listing market. The overall market for Initial Public Offerings ("IPO") in Canada has been in decline since 2013. IPOs for venture names have been in decline for over 6 years. Compared to 2010 levels, IPOs on the TSX are down 84% and IPOs on TSXV are down 97%. Although this struggle can partially be explained by macro-economic factors, the issue of a struggling Canadian listings market, particular for small cap names, is an issue that is widely recognized and being looked at as a significant problem. The Investment Industry Regulatory Organization of Canada recently hosted two roundtables to discuss specific market structure issues affecting small cap issuers to explore solutions to address this concern.

TAKING A MEASURED APPROACH

We believe that given the change in economics for market makers resulting from lower rebates that market quality will deteriorate if the rebate is significantly decreased. Recognizing these concerns, we suggest that the CSA take a cautious approach when decreasing active fees in general and in particular the restricted fee level proposed for Non Inter-listed Securities. The proposed $0.0017 fee cap represents over a 50% percent decrease from the highest active fee charged by any marketplace ($0.0035) at the time of

[6] For the period from Q1 2015 through Q2 2016. Source IRESS.

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the ORP Review and a 43% decrease from the level of the fee cap for all securities that becomes effective on July 6th 2016. Marketplaces have already proactively responded to participant concerns by lowering their active fees for Non Inter-listed Securities to significantly lower levels. We suggest that by revising the proposed cap for Non Inter-listed Securities to $0.0023 (which is the highest fee charged today by any marketplace for this segment of securities), the CSA will be able to effectively monitor any negative impact on market quality after which it can reconsider further decreases. Moving the cap to this level will still represent a significant reduction of 34% from the previous high and a 24% decrease from the fee cap that will become effective for Inter-listed Securities. Alternatively, we recommend that the CSA initiate a short term pilot program using the proposed $0.0017 fee cap or apply the proposed cap to a series of test securities before it is applied all Non Inter-Listed Securities. Each of these approaches will offer the same opportunity to monitor the impact of the change and reassesses if further action is necessary. However, should it be observed that market quality is harmed by the change; taking either one of these approaches will make it easier to reverse action in order to remedy the impact compared to making a formal rule change.

We understand the methodology used for the $0.0017 proposed fee cap was to compare the VWAP of Non Inter-listed Securities with Inter-listed Securities and then reverse engineer an equivalent fee for Non Inter-listed Securities that was equal in basis points to the $0.0030 fee cap approved in April. Understanding that costs were the main driver in this calculation, we believe that this approach fails to consider differences in the liquidity profiles of the two segments of securities and any impact to Canadian issuers. As outlined in our discussion above, given that Non Inter-listed Securities are less liquid than Inter-listed Securities than it is reasonable to conclude that a higher rebate (and associated fee) is needed to compensate liquidity providers for the added risk of making markets on more illiquid names.

NEED FOR REGULATORY MANAGEMENT OF INTER-LISTED SECURITIES

Given that Proposed Amendments differentiates between Inter-listed Securities and Non Inter-listed Securities, we believe that a current list of Inter-listed Securities ought to be maintained and made publicly available by the CSA or the Investment Industry Regulatory Organization of Canada. Today there are different lists of “inter-listed” securities used by different marketplaces for fee calculation purposes. In addition, these lists are generally updated manually therefore not ensuring that lists are updated in real-time or accurate. Should the CSA codify an active fee cap for Non Inter-listed Securities, participants need to be able to rely on the accuracy of this list and be assured that is updated free of any potential conflict of interests.

We thank the CSA for its consideration of these comments and would welcome the opportunity to discuss further our views with staff.

Sincerely,

Nasdaq CXC

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