Via email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

March 1, 2019

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor, Box 55
Toronto, Ontario M5H 3S8

and

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

Dear Sirs/Mesdames,

Re: CSA Staff Notice and Request for Comment 23-323 Trading Fee Rebate Pilot Study

This comment letter is being submitted on behalf RBC Dominion Securities Inc., Capital Markets and Wealth Management ("RBC" or "we"). We are writing in response to the Canadian Securities Administrators' ("CSA") Staff Notice and Request for Comment 23-323 Trading Fee Rebate Pilot Study published on December 18, 2018 (the "Proposal"). RBC appreciates this opportunity to comment on the above-referenced proposal to establish a pilot program to assess the impact of trading fee rebates on order routing behavior, execution quality, and market quality for interlisted and non-interlisted stocks. Our comments on the Proposal can be found below.

Overview

RBC strongly supports the Proposal and commends the CSA for the thoughtful and thorough work that it reflects. If adopted by the CSA essentially as proposed, and if implemented effectively, the pilot should provide data to enable the CSA to determine the impact of transaction-based fee rebates on order routing behaviour, on execution quality, and on market quality. That data can in turn be used by the CSA to support any appropriate reforms to Canadian equity market structure.

We have been encouraged that for a number of years the CSA has been considering a pilot study to look at the effects of the payment of trading rebates. We also believe it is beneficial for regulators to coordinate with their counterparts from other countries as our markets become increasingly interconnected. The coordination of the proposed pilot with a similar effort proposed in the United States increases the likelihood of success and minimizes potential adverse outcomes for interlisted stocks in the study.

We believe that the Proposal will provide valuable data to the CSA to determine the extent to which the current practice of payment of rebates is contributing to price opacity, increased intermediation within highly liquid securities, order flow segmentation, and conflicts of interest between brokers and clients, and thereby help the CSA to ensure that Canadian equity markets are more transparent, efficient, and fair for all investors.

Content

Subsamples

The Proposal's non-interlisted and interlisted subsamples are an essential feature of the pilot. Additionally, utilizing a phased approach and beginning the pilot with non-interlisted stocks should reduce the likelihood of unforeseen impacts. Adding interlisted stocks in coordination with the United States Securities and Exchange Commission Transaction Fee pilot should provide a seamless transition while reducing rebate arbitrage opportunities that would exist if the two countries acted independently. As the Proposal itself says, "the staggered introduction may alleviate concerns should the pilot begin around the time of an unexpected market-wide event." (Proposal @ 18) In addition, we agree with the match process and would further suggest that common stocks from as many sectors as practicable be included, to reduce the concentration risk an outsized exogenous impact could have on a specific sector, which could impact the results of the study.

Linked Pricing

In addition to prohibiting rebates, the pilot would also prohibit exchanges from offering a discount or incentive on transaction fee pricing "if such discounts are linked to the dealers' liquidity-providing activities." (Proposal @ 10) We fully support this prohibition. It is consistent with our view that "a pilot that limits or prohibits the economic incentive of rebates . . . without similarly restricting other inducements to trade, runs a serious risk of actually encouraging the use of such inducements and thereby undermining the integrity of the pilot." (See https://www.sec.gov/comments/265-29/26529-86.pdf at 3 (September 23, 2016 letter from RBC Capital Markets to former SEC Chair White)). For that reason, we believe that the prohibition on Linked Pricing should, if anything, be expanded to include a prohibition on any other inducements to trade, regardless of whether they are related to fee pricing. These inducements may include connectivity discounts, market data discounts, "…differentiated fees, bulk discounts, new order types, new venues and order books…", among others. (Proposal @ 18) Just as the Proposal prohibits Linked Pricing models because of their potential to distort order routing, execution quality, and market quality, so should it prohibit other inducements to trade that hold that same potential. To the maximum extent possible, the pilot should aim to ensure that trades are executed solely on the basis of transparent pricing of a stock.

Covered Trading Venues

We agree with the CSA that the pilot "be applicable to trading rebates paid by Canadian marketplaces, both exchanges and alternative trading systems ("ATS")." (Proposal @ 4) We further agree with the CSA that, in order to advance this objective of a broad study, the pilot should apply to inverted exchanges as well as to traditional exchanges. This approach is both logical and feasible.

Data Collection and Publication

We support the data collection and publication features of the pilot. As the Proposal states, "In the interest of transparency, we will make all codes publicly available via GitHub (the online code depository)." (Proposal @ 19) This will encourage more thorough analysis, and most importantly, will produce data and analyses that serve the core purpose of the pilot: to permit the CSA to assess the potential conflicts of interest, opacity, and fragmentation associated with transaction-based rebates and the effects that changes to those rebates have on order routing behavior, execution quality, and market quality.

Characteristics and Scope of Securities

We agree with the CSA's decision that the securities in the pilot should have a minimum threshold of medium liquidity at the time of the initial stock selection. (Proposal @ 11)

We believe that the impact of rebates on order routing, execution quality, and market quality is primarily a concern around the trading of larger, more liquid securities. Including in the pilot less liquid securities could have two negative impacts: first, the available liquidity for those securities could be adversely affected; and second, the extent to which rebates – rather than price movements – affect trading behavior and overall market quality in connection with more liquid securities could be more difficult to assess. For these reasons, we believe that the majority of securities within the pilot should be more liquid.

Similarly, we do not believe that, as a general matter, firms should be allowed to opt out of the pilot. Such a policy would, in our view, adversely affect the quality of the data and the credibility of the pilot. It could also potentially allow firms – including those with the largest, most liquid securities – to gain a potentially unfair advantage over competitors that decide not to opt out. Indeed, such a policy would create a perverse incentive for firms to opt out.

<u>Timing and Duration</u>
We endorse the Proposal's provisions for the duration of the pilot to match that of the SEC pilot on Transaction Fees. We also agree with the phased approach for the timing of the pilot, with non-interlisted stocks implemented first, as a way to minimize trade disruptions in interlisted stocks if the SEC's Transaction Fee pilot is delayed.

While there may not be any adverse effects in a Canadian rebate pilot for non-interlisted stocks, we are concerned about a regulatory arbitrage and the possible negative impact to interlisted stocks without a coordinated effort with the United States. Orders in interlisted pilot stocks may be concentrated at U.S. trading venues that offer trading rebates if the Canadian venues are prohibited from doing so in the same stocks. This could also have an impact on the results of the study. Therefore we recommend any study in interlisted stocks be delayed in Canada unless and until there is a coordinated effort in the United States.

<u>Disclosure:</u>
We also recommend that the CSA consider ways to increase disclosure around broker order handling. Specifically, increasing transparency around the handling of orders sizes greater than 50 standard trading units ("STU"), would benefit from additional broker order handling information upon request, including what venues their orders were routed to. This disclosure should encompass both venues that did — as well as those that did not — result in an execution. Brokers should also provide their institutional clients with information on their associated venue economics (e.g., average trading fees and rebates).

<u>Technology:</u>
We are sensitive to the technology cost impact of the pilot on the industry overall, particularly smaller dealers who execute institutional as well as retail orders. These technology cost constraints could impact the results of the pilot. Therefore we are hopeful that regulators consider the burden of these costs on the industry such that the impact to market participants is minimized so participation in the pilot is maximized.

Looking Forward: Potential Results, Reforms, and Benefits to Investors

Should the pilot be implemented as proposed and consistent with these comments, and should the data show that rebates are adversely affecting order routing, execution quality, and market quality, then we believe that the CSA should consider reform, including a substantial limitation, if not prohibition, on rebates for more liquid securities where data supports the conclusion that liquidity incentives are no longer necessary.

This reform is targeted and limited. It would not add significantly to the regulatory burden of the CSA or of market participants. And they would further the CSA's mission to protect investors; to maintain fair, orderly, and efficient markets; and to facilitate capital formation.

Conclusion

The CSA's proposal for a trading fee rebate pilot study is a carefully crafted, logical, modest, and data-driven step toward making Canadian equity markets more transparent, more efficient, and less conflicted. RBC applauds the CSA's action in putting the Proposal out for comment, we encourage continued progress in finalizing and implementing the Proposal, and we stand ready to provide the CSA with any additional information as it moves the Proposal forward.

Sincerely,

Rich Steiner
Head, Client Advocacy and Market Innovation

Cc:

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