



July 24, 2014

Anne- Marie Beaudoin  
Corporate Secretary, Autorité des marchés financiers.

Dear Ms. Beaudoin :

**Re: Notice and Request for Comments. Aequitas Neo Exchange**

**Restoring a free and fair capital market with fewer restrictions**

I am writing my comments in response to the Notice and Request for Comments relating to the application by Aequitas Neo Exchange Inc. for an Exemptive Relief in accordance with NP 11-203. Aequitas has selected the Autorité des marchés financiers (AMF) to act as principal regulator for this Exemptive Relief application.

My comments are in support of Aequitas' proposals and are based on ground realities and what matters to investors, issuers, broker-dealers and the economy. In regard to specific questions raised by OSC, I hope the theoretical pundits at Bay St. will present their analysis and their paralysis. Some comments against Aequitas' proposals may be similar to the comments of the pundits at Bank of Canada who since 2009 have predicted and warned investors about the rapid interest rate hikes that have not happened.

On August 15, 2013, I forwarded my comments as how the advocacy group, Aequitas Inc, has long term investors holding significant portion of Canadian capital market share who can restore fair and efficient capital markets as well enhance monitoring and enforcement effects of regulators. The regulators had a choice whether to allow a new exchange with innovative platforms that can provide what market participants need, or maintain the status-quo, a dominant stock exchange that is the darling of predatory traders where investors are the prey. On January 16, 2014, the OSC rejected market participants' proposed market structure.

OSC staff acted with good intentions but OSC guidelines and regulations led them to the wrong decision. I have a few more comments related to the regulator's unfair decision that failed to recognize the issuer/ investor-centric innovative market vision. Aequitas' ownership represents proportional representation of the market and is guided by the highest standard of corporate governance.

I would like to thank AMF for giving investors the opportunity to express their opinions on this very important initiative for the capital markets that will provide investors with protection from predatory traders, and offer higher market quality through better transparency, price discovery, liquidity, spread, competitive pricing and other innovative alternatives for capital formation and will help in economic growth.

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### **Market participants disagree with the regulator's rejection of Aequitas' application**

The regulator ruled Aequitas anti-disruptive trading mechanism is unfair and unreasonably discriminatory against the unjust aggressive predatory traders. The regulator believed Aequitas pre-emptive protective strikes are unfair because it would infringe on the rights of predatory traders to implement aggressively destabilizing trading strategies to create vulnerable market conditions, exacerbate price volatility, increase intraday volatility and significantly reduce liquidity. The OSC decision was a victory for market perpetrators like predatory traders who can implement trading strategies that can trigger systemic and economic risks. These type of unfair predatory trading will be ineffective or not possible under Aequitas' proposal .

Predatory high frequency traders (HFTs), though less active in small capitalization stock than large capitalization stock, the majority of their activity in small capitalization stock is attributable to aggressive orders. Small and medium companies employ more Canadian workers and contribute significantly for economic growth and negative activities by HFTs are harmful to the economy. Predatory HFTs increase the transaction cost for institutional investors and increase the intraday trading losses for retail investors. Struggle for domination among the technological front running HFTs leads to liquidity consuming trades, increases

intraday volatility and reduces liquidity. HFTs' ratio of liquidity consuming trades to the total trades doubles when HFTs compete for volume. These types of negative outcomes will be prevented or minimized to maintain higher market quality under Aequitas' proposal.

The regulator's decision leaves long term investors the easy victims of market manipulation. This decision to support predatory trading, stock exchange price gauging is well aligned with regulators own market behaviour. For example, OSC recently introduced a fees hike that reinforced investors distrust toward the capital market. Unlike the SEC, the provincial regulators don't support greater transparency of market data and incentives and thereby fail to promote fair trading practises. By contrast, US exchanges are not shielded from scrutiny. For example in May 2014, NYSE agreed to pay SEC a fine of \$ 4.5 million for sending data through its proprietary feeds before sending data to the consolidated feeds. A study mentioned in SEC's 2014 equity market structure review related to HFT, showed that an increase in regulatory fees that affected HFTs led to a significant increase in quoted and effective spread in the Canadian equity markets in 2013.

### **Securities regulators are unable to earn the trust of markets**

Legislators should make note of the fact provincial regulations lack credibility and thereby prevent regulators from having the confidence or the trust of market participants. Markets therefore believe regulators cannot fairly assess the Aequitas Neo Exchange's benefit statement - that it can offer higher market quality and strengthen fairness and efficiencies in capital market.

Canadian provincial regulators are unable to earn the confidence of the market because regulators believe in many market myths and fail to understand market realities. Many of the rules they recommend are unsuitable to investors and issuers. The rules regulators draft and impose reflect these myths like: investors lack the knowledge to make prudent decisions, and issuers flood markets with too many risky products.

Regulators failed to present compelling evidence to justify imposing numerous restrictions and burdening investors and issuers with high compliance related costs. In addition, investors find many regulatory rules unnecessary and deny them the opportunity to make a profit. In order to gain credibility and earn the confidence of market participants, market rules must be based on facts, the trading floor realities.

Under the pretext of investor protection, a few with deep pockets and vested interest successfully lobbied regulators and legislators to impose numerous investor and issuer restrictive policies to curtail market participants' freedom and cause price gouging. Demutualization of exchanges led to higher market data fees and the listing strategy of dominant exchange has put Canadian corporations at the bottom. In reality, market participants hardly experience any protection, instead are burdened with high fees. Few investors preying on the majority has occurred for the past 200 years. At the time, fastest horses and economic espionage gave a few predatory traders the advantages at LSE and today ultra -low latency data, order routing algorithms give few traders the advantage over majority traders. IIROC (2012) classified 11% of traders on Canadian equity markets as HFTs with the highest order-to-trade ratio and they accounted for 94% of order messages. HFTs momentum ignition strategy creates a series of orders and trades to manipulate stock prices. HFTs order anticipation strategy seeks to find large orders and trades ahead making prices increase for buyers and decrease

for sellers. This creates a serious problem for long term investors. Aequitas wants to make the market a level playing field and this principle of fairness is inconsistent with provincial regulations that provide the edge to predatory traders and dominant exchange. Unlike US investors, investors in Canada do not know the amount spent by lobbyists to protect and strength the predatory HFTs conduct and practices. In US, between 2008-2012 firms associated with HFTs spent more than \$ 10 million lobbying Congress, SEC and the CFTC and significant portion of spending was when Congress debated financial regulatory reform.

Provincial regulators have not undertaken any comprehensive cost-benefit study to determine any benefits from these regulations. In fact they have no idea. Provincial regulators will be reluctant to undertake a study that surely highlights their harmful policy rules on market participants and economy. Provincial regulators haven't proven any benefits of their rigid laws. Lack of political will and lack of cooperation at various legislative and regulatory levels continue to hurt markets.

Over the past few years Canadian market participants have demonstrated their lack of confidence in Canadian market structure and regulations with their business decisions. For example, provincial regulations continue to drive Canadian market participants to other jurisdictions like the US where their rules make sense. Furthermore, what provincial regulations fail to achieve in Canada, US federal regulations can achieve. US markets offer real liquidity, price discovery, competitions and choices, even though issuers and investors have to pay higher compliance cost at times. In addition, investors and issuers enjoy the benefit of larger market size in US. There are other disadvantages that are unique for investors in Canada such as duplication and lack co-ordination among rules between provinces. The lost incurred by investors due to restrictions and higher fees can be quantified, but not the mythical benefits from investor protection rules. On the other hand, financial benefits earned by predatory traders and dominant exchange can be measured. What investors actually need is protection from unnecessary rules that restrict their freedom to attain their long term investment objectives.

The major risk investors in Canada face today is regulator risk. Investors need protection from regulator risk. In the absence of a federal regulator, provincial regulators importing and enforcing US style federal regulations will continue to harm Canadian capital markets participants. Regulators are more focused on the rule of law than on the spirit of the law and fail to modify these foreign rules to Canadian markets. Regulators continued failure to understand Canadian markets result in investors and issuers facing lower market quality and are compelled to move to other jurisdictions for better trade execution. Regulators shouldn't consider US markets and Canadian markets as the same. In US, there are federal securities regulators, 11 exchanges and more than 40 alternative trading systems while Canada has only one dominant exchange.

Regulators failed to show the benefits of their numerous restrictions on investors and issuers. Under a democratic economic structure, market participants have the rights to choice the structure that best serves their interest, which normally aligns with the legislators' vision to create fair and efficient capital markets. Aequitas Neo Exchange innovative business solution will not only restore market confidence, it will lighten the financial burden imposed by regulations. Denying investors the market structure they desire as outlined in Aequitas proposal will result in investors and issuers leaving Canadian markets and others will end up paying higher fees and incurring monetary losses without compensation. For example in 2013, OSC imposed a 13% fee hike and increased its revenue to \$98 million but investors hardly benefited. On the contrary, Aequitas hopes to lower fees and help investors and issuers attain operational efficiency.





### Commercial solutions for regulatory enforcement failures

One of the major factors that continue to undermine regulator trust, credibility and market integrity is the fact these securities rules are unenforceable in courts. There is no accurate way of measuring investment frauds and the harm inflicted on investors in Canada. Even for the newly formed OSC- IMET to be an effective enforcement team, the criminal code needs to be amended. Another new team, OSC- JSOT can only lay quasi – criminal charges. Without prosecutors being in a position to consider market manipulations like insider trading as criminal offence, all types of over-regulations cannot create an efficient or fair capital markets. Enforcement without prosecution only encourages market manipulation because perpetrators, as usual, end up making net profit after paying fines.

Fortunately, market participants who understand perpetrators and market realities better than the regulators have proposed an innovative market solution that will curtail manipulative or deceitful behaviour and restore market confidence through market monitoring and self enforcement

Aequitas’ proposal will prevent unethical and criminal wrongdoing in capital markets. This market initiative will truly provide investor protection that over regulated rules failed to achieve. Aequitas Neo Book will act like an investor protective shield and prevent investors from becoming victims to predatory HFT strategies. In Canada, capital market criminals enjoy Canadian charter rights, not the victims who are mainly the long term investors. In fact, under provincial securities laws, investor rights are restricted to strengthen the rights of wrong doers. The regulator’s initial denial of Aequitas proposal clearly demonstrates that predatory HFTs are above the law and can infringe on the rights of long term investors who seek protection under Aequitas Neo Exchange.

Aequitas’ market solution will usher in a new era of freedom for prudent risk taking with lesser compliance related cost. This will prevent the exodus of market activities to foreign jurisdictions seeking protection and better execution. Aequitas’ investor protective proposals will strengthen fairness, cost effectiveness and create a globally competitive Canadian capital market.



## **Rejection of market participants' proposal is due to regulatory incompetence**

Provincial regulators are engaged in a territorial power struggle and they can't agree among themselves for a harmonized approach towards investors. Even the Canadian Securities Administrators (CSA) formed by provincial and territorial regulators cannot agree with all provincial regulators on major policies and rules. For example under CSA's passport system, approval of one regulatory commission should allow registration in other provincial commissions, yet Ontario's OSC with the largest capital market refuses to recognise and does not participate in this process. In the past, CSA rules reflected the risk tolerant investors of western Canada but now that has changed. Investors in western Canada are now subjected to more investor restrictions. Even the federal financial regulator, the OSFI, who is concerned about growing financial risk continues to fail in its attempts to slow down the rising home prices in an economy that is hardly growing, with high unemployment because the regulator does not understand ground realities. Regulators' lack of understanding of markets, the conflicting regulations of many provinces and loopholes can hardly protect investors.

## **The proposal enhances market reform to serve investors and issuers**

Market participants who understand their needs have clearly expressed in this proposal the type of market operations that best serve their interest. Unfortunately Canada doesn't have a national securities regulator that can assess in fairness Aequitas Neo Exchange's suitability to serve the need of Canadian securities markets. The Securities Exchange Commission (SEC) was created in 1934 during the Great Depression after the Crash of 1929 because securities regulations at the state level was a failure. Just like the current failures at provincial and territorial level in Canada. It is possible to create some form of a national regulator in Canada as countries like Australia, Germany and US with diverse regional interest have succeeded in creating a national regulator. The current regulatory patchwork known as Cooperative Capital Market Regulatory System which now includes Ontario, British Columbia, Saskatchewan and New Brunswick is at least in the right direction, balancing the need to have useful investor protection rules while creating condition for regional capital formation and economic growth. The Supreme Court mentioned the need for a co-operate national regulatory system to protect Canadian financial sector and economy from systemic risk. Investors have very limited protection in case of regulator or systemic risk. Free market activities are based on interactions between those with different views, some want to buy while others want to sell the same security. Regulators' undue influence through unnecessary rules discourages free market interaction between investor and issuer. Regulators and legislators must put investors' and issuers' interests first, not the interest of market manipulators. Aequitas' proposal is all about providing choices and putting investors' and issuers' interest first.

In the absence of a national regulator, the current mandate of provincial regulators must be redefined. Therefore the current role of Canada's colonial provincial securities regulatory system as serving regional oligopolies must end. Provincial regulators continue to harm markets and economy with their own narrow vision, preventing investors from being competitive in interdependent global economies. As a result, Canadians investors and issuers are moving to foreign jurisdictions to enjoy freedom and choices. In lieu of more provincial regulatory rules that burden investors and restrict their freedom, the shareholders of Aequitas, as market participants who hold significant capital market share in Canada have proposed a cost effective and self

regulating business solution that strengthens fairness, efficiencies and competitiveness in capital markets. This should be the model to reform and restructure Canadian capital markets to serve investors and issuers.

Provincial and territorial regulators must be partners in implementing commercial solutions put forwarded by market participants. Legislators gave securities regulators wider powers, yet regulators failed to fulfil their mandate. Aequitas proposed a commercial solution in a way that can self-regulate market operations to restore a free and fair capital market. Aequitas represents Canada's biggest bank, major pension funds and mutual funds companies whose activities represent significant portion of market activities. Aequitas' innovative platform will help capital formation at the early, mid and later stages of companies' development especially for small and medium corporations and be partners for economic growth and prosperity. Aequitas hope to build an innovative private securities platform for corporations to raise capital from accredited and other qualified investors as well create a secondary private securities trading platform that provide investors and issuers needed transparency and liquidity. Aequitas' proposal is also committed to fostering committed market making, providing reliable liquidity at all times and even allowing HFTs a certain percentage of trades for providing useful liquidity. Aequitas innovative funding access for businesses will prevent companies seeking capital in foreign markets and reverse the trend of Canadian listed securities trading more and more volumes in US. Legislators letting market participants choose market activities that best serve their interest as proposed in Aequitas application is the right decision.

It is imperative provincial legislators assess this commercial model put forward by major market participants that fulfil the mandate of provincial and territorial regulators. The spirit of the provincial securities regulations and the free market proposal of Aequitas Neo Exchange are well aligned. Therefore if the letter of the law is inconsistent with the market participants' proposal, then it becomes the duty of legislators and regulators to grant exemption. Regulations should serve market needs, and investors and issuers should not be compelled to fulfil regulatory requirements that make no sense to them but only make sense to predatory traders and dominant exchange to make unfair profits. For a similar reason the Charter of Rights and Freedoms has the notwithstanding clause to ensure laws make sense and are useful to the society.

The economic Charter rights of Canadian investors should be the guiding principles to assess Aequitas' application and reform Canadian securities regulations. The major challenge for the legislators is to ensure policies and rules serve the majority of investors. This means instead of taking away investor rights under the current securities laws, regulations must nourish investor and issuer freedom, create competitions and offer choices in capital market as outlined in this proposal. Current market structure and regulations does not promote the growth of small and medium companies that create majority of jobs and economic growth. Aequitas Neo Exchange expresses the hopes and dreams of the market and requests regulators and legislators to recognize and respect investors' choices and rights. Neo Exchange ownership represents a larger share of Canadian market participants and their commercial proposal seeks investor protection.

Canadian provincial regulators, though an independent crown corporation, are accountable to the provincial legislature through Minister of Finance. Canadian investors who elect provincial legislators are seeking through Aequitas' proposal more freedom and higher market quality.



### Letting the market participants decide

Under federal and provincial stimulus, the Canadian stock index had recovered from the 2008 losses and overall valuation of blue-chip stocks are well above historical average. Though stock prices may have surged to an unsustainable level, the economy is facing potential long term stagnation with high unemployment. The reason being regulators and legislators fail understand the need of the majority of market participants and fail to align capital market activities with economic growth. Giving investors the freedom to make prudent choices will align economic activities with stock market activities. Under the current regulations and market structure, Canada's dominant stock exchange is the killing field for predatory traders and for price gouging.

The Ontario Securities Commission's outreach to investors through requesting comments is a step in the right direction. Hopefully this leads to recognising investor rights and restoring a free and fair capital market that represents the choices of market participants with lesser external regulatory restrictions. Regulators want to impose restrictions to protect investors while investors want freedom to protect themselves. It is better to understand than to be understood.

Yours truly,

A handwritten signature in blue ink that reads "Surendra Jeyarajan". The signature is fluid and cursive, with a long horizontal line extending to the right.

Surendra Jeyarajan FMA FCSI