



March 1, 2019

Via Electronic Mail

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 of New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Service (Newfoundland and Labrador)
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Department of Justice, Government of Nunavut

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

Dear Sirs/Mesdames:

The Healthy Markets Association¹ appreciates the opportunity to offer our comments on the CSA Staff Notice and Request for Comment 23-323 – Trading Fee Rebate Pilot

¹ The Healthy Markets Association is an investor-focused not-for-profit coalition working to educate market participants and promote data-driven reforms to market structure challenges. Our members, who range from a few billion to hundreds of billions of dollars in assets under management, have come together behind one basic principle: Informed investors and policymakers are essential for healthy capital markets. To learn more about Healthy Markets and our members, please see our website at <http://www.healthymarkets.org>.

Study.² We commend the Canadian Securities Administrators (CSA) for proposing a robust and well-designed pilot, and commend you for seeking to harmonize and coordinate the Canadian Pilot Study with the U.S. Transaction Fee Pilot.³

The issues the proposed pilot seeks to address are similar to those in the United States. The CSA proposal is intended to explore the extent to which two type of significant order routing incentives – exchanges’ transaction fees and rebates – may be impacting brokers’ order routing decisions⁴. Broker’ best execution obligations should require them to route orders based on their customers’ best interests, not their own. In other words, a broker’s routing decisions should not be unduly influenced by a particular venue’s fee or rebate structure.

We commented extensively⁵ on the design and implementation of the U.S. Transaction Fee Pilot including advocating for U.S. regulators to coordinate inter-listed securities with their Canadian counterparts.⁶ Canadian regulators are proposing a matched pairs design to facilitate comparison between the treatment and control groups. We are supportive of such an approach. Market capitalization, share price, trading volume and intra-day volatility are all meaningful drivers of transaction cost. Pairing securities based on these drivers should facilitate a like-for-like analysis.

While we will not offer comments on all aspects and questions posed by the CSA request for comment, we will offer some specific responses here.

Question 2: We propose to introduce the Pilot in two stages, with non-interlisted securities first, followed by interlisted securities. Do you believe that such staggered introduction will cause material problems for the statistical analysis and the results of the Pilot? If so, please describe your concerns in detail.

We do not believe that the proposed phasing will create material problems. The CSA study should coordinate the inter-listed securities to mirror the timing of the U.S. Market

² Trading Fee Rebate Pilot Study, CSA Staff Notice and Request for Comment 23-323, Dec. 18, 2018 available at http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20181218_23-323_trading-fee-rebate-pilot-study.htm.

³ Transaction Fee Pilot for NMS Stocks, SEC, 84 Fed. Reg. 5202, (Feb. 20, 2019), available at <https://www.govinfo.gov/content/pkg/FR-2019-02-20/pdf/2018-27982.pdf> (Final Rule).

⁴ While transaction fees and rebates are common in the United States and Canada, they are not the only potential incentives that could create conflicts of interest for brokers in order routing. Notably, under the MiFID II regime in Europe, the regulatory focus has been on eliminating “inducements” that could create the “principal-agent problem.” That is more than just fees and rebates. Thus, while this Proposal addresses significant contributors to the current conflicts of interest, it will not eliminate or address all potential sources of conflicts.

⁵ See, e.g., Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, May 24, 2018 available at <https://www.sec.gov/comments/s7-05-18/s70518-3704495-162465.pdf> (May 24, 2018 Letter); see also, Letter from Tyler Gellasch, Healthy Markets Association, to Brent J. Fields, SEC, July 6, 2018, available at <https://www.sec.gov/comments/s7-05-18/s70518-4007255-167280.pdf> (July 6, 2018 Letter).

⁶ May 24, 2018 Letter, at 34.

Transaction Fee Pilot. We also believe that coordination of inter-listed securities would pose the least amount of unintended consequences for either market leading to more robust results of the CSA study. We therefore recommend that regardless if the CSA chooses a staggered pilot or a pilot that will commence both inter-listed and non inter-listed securities that the program should mirror the implementation for inter-listed securities to that of the U.S. Pilot.

Question 3: Several Canadian marketplaces offer formal programs that reward market makers with enhanced rebates in return for liquidity provision obligations. On the one hand, such programs may benefit liquidity. On the other hand, one of the primary objectives of the Pilot is to understand if rebates cause excessive intermediation. In your opinion, should exchanges be allowed to continue using rebates or similar arrangements for market making programs during the Pilot? Do you believe any constraints on such programs during the Pilot to be appropriate?

Incentives paid to market makers expand complexities and offer opportunities for evasion and abuse. As we explained to the SEC in our May 24, 2018 Letter,

The Proposal's market maker exception appears to create unnecessary complexities, may undermine the utility of the pilot, and may discriminate against competing brokers.⁷

However, in rejecting our concerns, the SEC's Final Rule adopting the fee pilot explained:

The Commission continues to believe that permitting exchanges to adopt rules to offer Linked Pricing to their registered market makers for securities in the no-rebate Test Group preserves the ability of an exchange to attract market makers through non-rebate incentives and thereby helps maintain the baseline framework in which exchanges can provide incentives to their registered market makers. Commenters highlighted the importance of ensuring that any new rules that exchanges propose to provide Linked Pricing to registered market makers in the no-rebate Test Group be designed so as to not inhibit the Pilot's ability to generate useful data on the impact of rebates on order routing behavior, execution quality, and market quality. The Commission agrees that if they are not narrowly tailored, these non-rebate incentive programs could continue to potentially distort transaction fee pricing, particularly if the exchange's fees are set at a subsidy level above the natural equilibrium within the current regulatory structure to

⁷ May 24, 2018 Letter, at 31-34.

subsidize these market maker incentives. Rather, the market maker exception to Linked Pricing is intended to permit an exchange to impose rules for its registered market makers in ways that would improve its market in a meaningful way, such that it could use the enhanced liquidity provided by its registered market makers to improve its displayed quotation and thereby attract buyers and sellers to the exchange. The non-rebate incentives would only apply to trading activity by a registered market maker in its capacity as a market maker (i.e., acting as principal), and would not apply to any customer activity or activity from other trading desks or business units affiliated with the market maker (and possibly using the same MPID), be it agency, principal or riskless principal trading, traded by or through such market maker. Accordingly, only a registered market maker's principal trading activity in its capacity as a registered market maker in the no-rebate Test Group would be able to satisfy any market quality metrics, and the only trades that would be eligible to receive the non-rebate incentive pricing would be a registered market maker's principal trades in its capacity as a registered market maker in the no-rebate Test Group securities.⁸

Question 6: We propose a number of market quality metrics. Do you believe that we should consider additional metrics? If so, please outline these metrics and provide supporting data and analysis, if available, to demonstrate their empirical importance.

Institutional investors often bear significant costs for orders that are never executed or unnecessarily delayed in their execution. The placement of marketable, limit orders at the NBBO is a key component of many schedule-based trading strategies (e.g., TWAP, VWAP, POV) that are frequently used by institutional investors. We would encourage regulators to measure the delay cost of unfilled, canceled orders as an additional measure of execution quality.

Question 7: Given the challenges that ETP matching presents, can the goals of the Pilot be achieved without including ETPs in the sample? If ETP inclusion is important, can you propose a way to construct a matched sample that addresses the concerns identified above?

⁸ Final Rule, at 5222.

ETPs should be included in the pilot, and they are in the US transaction fee pilot. We suggested that the SEC rotate ETPs through the various buckets.⁹ However, the SEC ultimately decided to take an alternative approach.

In the SEC's final rule adopting the pilot, it declared

The Commission does not believe it will be able to draw meaningful conclusions about the impact of changes to transaction fees and rebates on ETPs by observing the effects of the Pilot on other securities, in part because ETPs have a unique create-and-redeem process that does not apply to other NMS stocks.

...

The Commission recognizes the concern that securities placed in one treatment group could be impacted differently than similar securities placed in a different treatment group. While that effect could occur for any security (e.g., stocks of different operating companies in the same industry), it could potentially be more prominent for ETPs that may be substantially similar. Nevertheless, the Commission notes that similar ETPs are not necessarily identical and many other factors influence investor demand and trading, including expense ratios, trading commissions, and existing holdings.¹⁰

Lastly, the SEC declared that rotating ETPs was too complicated and that grouping them

introduces its own complexity in that categorizing ETPs according to their underlying holdings (and potentially other characteristics) involves the exercise of subjective judgment. In addition, grouping similar ETPs can negatively impact the representativeness of the different treatment groups, particularly if all of the similar ETPs are similar in volume, price, and market capitalization.¹¹

Additionally, we note that any ETPs included in the CSA pilot should consider the make-up of securities contained within the ETP. Many ETPs could include underlying

⁹ July 6, 2018 Letter, at 7.

¹⁰ Final Rule, at 5210-11.

¹¹ Id., at 5211.



inter-listed securities and consideration to those ETPs should also mirror the inclusion of the broader inter-listed approach proposed by the CSA.

We thank you for your thoughtful and comprehensive proposal to foster market integrity for the benefit of investors.

Sincerely,

A handwritten signature in black ink, appearing to read "Tyler Gellasch", written in a cursive style.

Tyler Gellasch
Executive Director