OSI OMEGA SECURITIES INC

February 28, 2019

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

Me. Anne-Marie Beaudoin
Corporate Secretary
Autorite des Marches Financiers
800, rue du Square Victoria, 22 etage
Montreal Quebec.

Omega Securities Inc. (OSI), the operator of Omega ATS and Lynx ATS, thanks the Canadian Securities Administrators (CSA) and the Ontario Securities Commission (OSC) for the opportunity to comment on the proposed Trading Fee Rebate Pilot Study. OSI has concerns about the objectives and methodology of the proposed study.

In evaluating the maker taker / inverted maker taker model or any other issue, it is necessary to look at not only the potential negative impacts but also the positive benefits that may be negatively impacted by the changes. The proposed pilot study only focuses on the negative so a true cost/ benefit or understanding of trade-offs is not possible unless those benefits are also identified and measured. For example, the methodology suggests that the CSA will be looking at liquidity, but what about the ability to innovate and encourage adoption or competition and the impact of lack of competition? The rebate fee model was originally introduced to allow new entrants to compete with incumbent marketplaces. Therefore, we believe that a pilot study should encompass methodologies to carefully consider the potential impact of removing rebates on the competitive environment.

Fee flexibility within a regulated framework is fundamental to encouraging adoption of new products and facilitating competition. Provided the fee structure does not unreasonably disadvantage any class of investors, regulators should carefully consider the impact on innovation and competition when reviewing new fee structure changes.

Since the introduction of maker taker and taker maker fee structures, liquidity has increased and market participants have seen a progressive decline in commission fees, and the cost of execution. The rebates and discounts have provided revenue that has been indirectly returned to the most fee sensitive market participants in the form of lower commissions.

Spreads are tighter since rebates were introduced. Liquidity at the touch has improved, dark pools have introduced price improvement, and improved hidden liquidity rebates have lowered the cost of a retail trade execution in Canada by on average1/3 to ½ cent per share.

Innovation has flourished and with best execution guaranteed and mandated, these different models have been able to appeal to different types of investors. We acknowledge that complexity has increased, but the necessary investments have already been made by the marketplace. In our view, rolling this back will have little effect on reducing investment industry costs. If rebates are reduced or eliminated the result in our view will be to increase the already high cost of trading for the Canadian retail investor. This could be one of the unintended consequences of this pilot study.

Regulators and the architects of the study must keep in mind the differences between US market structure and Canadian market structure. In the US the bulk of retail trading is executed by wholesale market makers who pay for access to this flow. In return they guarantee execution and some form of price improvement. In Canada this practice is banned. The cost of trading for a retail client in Canada is already many times higher than in the US. Limiting rebates will further this price gap and ultimately harm the Canadian retail investor. The smaller marketplaces that depend on these incentives have provided much needed competition and downward pressure on costs and have benefited the Canadian marketplace.

The proposal for the pilot study seeks to investigate if the payment of rebates and cumulative volume discounts:

- Create conflicts of interest for dealer routing that may be difficult to manage
- Contribute to an increased segmentation of order flow
- Contribute to increased intermediation on actively traded securities

Conflict of Interest

It is necessary to evaluate the quality of best execution in order to properly analyze conflicts. Execution of orders is subject to the requirements of best execution, which should mitigate if not eliminate potential conflicts. Best execution has been the topic of many debates through the years and regulations have been developed to address this issue. All broker dealers in Canada must have policies in place to define best execution and how it should be achieved. With this in place, does that not address this conflict of interest issue? Further, the Canadian capital markets operate under a strict and well supervised regulatory environment. This is further complemented by the Order Protection Rule and the use of a Best Bid and Offer book and trading continuously monitored in real-time by IIROC. Rebates are put in place to provide an incentive for liquidity where, all things being equal, broker dealers can choose which marketplace to send their orders to. It does not provide an incentive for broker dealers to receive worse fills for their clients.

It has been proposed that the perceived conflict of interest that is allegedly driving broker dealers' decisions to send immediately marketable client orders to inverted venues, while parking orders that cannot be immediately filled to maker taker venues for the passive rebates, is at the heart of the conflict. This is simply untrue. The observed behavior is a function of our inefficient market data distribution; in short, clients (mostly retail) cannot see their passive orders unless they are parked to the incumbent listing exchange. Most broker dealers only offer the primary listing exchanges' market data to their clients. In addition to this obvious limitation, broker dealers handling client orders are motivated to rest limit orders to the incumbents in order to participate in the opening and closing auctions. If a dealer were to miss an opening or closing print that was perceived by the end client to be within their order handling instructions and price limit, the dealer could be held responsible and would need to make the client whole by adjusting the fill and assuming the loss on the difference. The lack of a comprehensive universally available consolidated data feed creates disincentives to use certain venues and incentives to use other marketplaces.

Segmentation of orders is not intrinsically harmful to the quality of marketplaces

Fees are a key differentiator between different commercial entities competing for order flow. This is true of both marketplaces and broker dealers. This is not, however, order segmentation; rather it is an example of fragmentation. Although it is true that fragmentation can lead to opportunities for intermediaries to capture spread on a short-term basis, there is no evidence that this market structure is harmful to investors. On the other hand, real marketplace segmentation – a marketplace offering different pricing or functionality to its participants based on some unreasonably discriminatory criterium – is highly detrimental and is diametrically opposed to fair access.

Retail traders demand immediate price protected fills at the lowest cost, this constant flow attracts Liquidity Providers that are willing to pay for the constant flow. This subsidizes the retail trade, encourages lower commissions and compresses spreads.

Complexity arises because of diversity of trading objectives and mechanisms, not because of fees.

Increased Intermediation

The Canadian marketplace has always been illiquid (in relative terms). It has required expensive hands on intervention to maintain an orderly institutional market, with many venture stocks being one keystroke away from no bid.

The arrival of Electronic Liquidity Providers was originally concentrated on the top names, but over the years we have seen trading in lower tier names. We have seen one of these institutions opening in Canada as a full-fledged broker dealer, who will trade on more and more Canadian listings. Traditional exchange sponsored market makers have always been subsidized in some form to provide liquidity to marketplaces. Today the form of subsidization is partly taken up by rebates in lieu of marketplace subsidies.

OSC Burden Reduction Taskforce

As we were recently reminded, the OSC established in November of 2018 a special Burden Reduction Taskforce, yet we are now being asked to prepare for a complex experiment. The fee rebate pilot study will require complex system changes and will force us to deny our subscribers the approved pricing we intended for them. In addition, we believe the pilot study will result in increased costs for market participants such as vendors (SORs, and builds), broker dealers (compliance and regulatory), and retail investors (spreads and increased commissions to make up for lack of rebates). We believe it is counterproductive to innovation in the marketplace to be embarking on a project that will create an increased burden. We are supposed to be reducing undue burden and costs rather than compounding them.

Comments and Questions on Implementation

- We note that many US listed companies are asking to be excluded from the SEC pilot. They are asking to be excluded because they are concerned about lower liquidity, wider bid offer spreads, and ultimately a higher cost of capital. Has the CSA consulted with Canadian issuers on this issue? Are there plans to involve issuers in the pilot should it move forward or will issuers be forced to participate once selected for the sample? We believe this issue should be carefully considered.

- We have read suggestions that rebates lead to excessive intermediation. We don't think there is such a thing. We believe that more intermediation equals tighter spreads, resulting in better quality execution for investors.

- We believe that the potential reduction or elimination of rebates will result in higher costs for retail investors. Should broker dealers not be able to earn these valuable fee rebates, then their costs of execution will increase, and they will likely choose to pass these increased costs on to their clients.

- We do not believe there is enough evidence to suggest that a pilot in Canada is warranted. There is a risk of creating a legacy that is a vicious circle. The Canadian market has evolved from monopoly, to increased competition and innovation and it could go back to near monopoly. Should this occur, broker dealers will ultimately get frustrated with the near monopoly and motivate the move to support competition all over again. More competition and pricing options make our market better not worse. Taking away the rebate tool will restrict innovation and competition.

- We are concerned about the pilot's impact on displayed markets, with the potential to weaken them versus non-displayed markets. The pilot will also enable uneven trading patterns in the marketplace, with some symbols eligible for rebates and some without. Adverse selection to lit quotes widens spreads and only benefits dark pool liquidity providers.

- This pilot study is an experiment. In our view, experiments should be performed in a lab, not in a production environment. There are a number of ways to achieve this, we would be pleased to share our ideas on this with you.

US Litigation

As you are no doubt aware, the three largest marketplace operators in the US have filed lawsuits against the SEC in federal appeals court to stop the SEC pilot from moving forward. We believe this action sends a strong message about the potential overreach in jurisdiction of the SEC. We think the CSA should take note of this development.

In our option, the CSA should not proceed with the Canadian pilot while these lawsuits are outstanding. We respectfully request the CSA to put the Canadian pilot study in abeyance until the SEC lawsuits are resolved.

Conclusion

In conclusion, OSI believes that this pilot study does not address a current significant market failure, nor consider the offsetting benefits as part of its analysis. We believe the only result of this experiment if rebates are altered or banned will be to raise to cost of execution for retail trades. Trade execution profit margins across the industry have been cut forever, and high touch intervention trading is over. The advantage held by the incumbent marketplace is more limited than in the past. Multiple markets and Electronic Liquidity are the new reality. Rebates may seem like an easy target in a complex marketplace, but we believe that there are more prevalent conflicts to focus on, such as broker dealer order routing to affiliated platforms. Finally, there is serious concern about the SEC pilot study in the US which we believe should inform the CSA's decisions as to how it moves forward with a Canadian pilot study.

Sincerely,

Laurence Rose *Sean Debotte*

Laurence Rose, Chairman

Sean Debotte, President & CEO