



Susan Copland, B.Comm, LLB.  
Managing Director

Secretary  
Ontario Securities Commission  
20 Queen Street West  
19th Floor, Box 55 Toronto, ON  
M5H 2S8  
[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

Anne-Marie Beaudoin  
Corporate Secretary  
Autorite des marches financiers  
800, square Victoria, 22 étage  
Montreal, QC H4Z 1G3  
[Consultation-en-cours@lautorite.qc.ca](mailto:Consultation-en-cours@lautorite.qc.ca)

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**Re: Proposed Amendments to National Instrument 23-101 *Trading Rules (the "Proposed Amendments")***

The Investment Industry Association of Canada (the "IIAC" or the "Association") appreciates the opportunity to comment on the Proposed Amendments. The Association applauds this initiative, which recognizes, and attempts to correct many of the unintended negative consequences created by the Order Protection Rule ("OPR").

The IIAC supports the underlying objectives of the OPR, which was intended to foster competition among marketplaces, which would in turn enhance service levels and innovation, and decrease costs in the investment industry. However, the current structure of the OPR is characterized by asymmetrical regulation, which has resulted in the protection of marketplaces that provide little or no value, at the expense of industry participants and clients. The inefficiencies and regulatory subsidies inherent in the

existing model have resulted in pricing models for access, trading and market data that would not be sustainable in a free market environment. In addition, the structure of the OPR may have created opportunities for new market entrants whose actions are perceived to be disrupting the ability of dealers to achieve best execution for their clients.

It is critical that the regulatory solution to these problems balance the benefits of competition by ensuring the barriers to entry are not prohibitive, while preventing unnecessary and counterproductive fragmentation that drives up costs without a commensurate increase in value to the industry.

In the course of our member consultations regarding the Proposed Amendments, it became evident that the number of issues that are directly and indirectly affected by the OPR, create significant complexities in formulating solutions that address the problems inherent in a multiple market environment. The priority placed each of the issues of concern differs among our members, and as such, a number of alternative solutions were proposed, based on different business models. Although no approach received complete consensus among our members, we believe our response represents a general consensus among the majority of our members. All members did agree that the regulatory reforms related to the multiple market environment and the OPR should be implemented as a cohesive package, so that the regulatory solution address all of the issues relating to OPR, including market fragmentation, captive consumers, market data pricing, trade pricing models and contracts between marketplaces and dealers.

### **Initial Implementation Questions**

**Question 1: Please provide your views on the proposed market share threshold metrics, including the types of trades to be included in and excluded from the market share calculations, and the weighting based on volume and value traded. Please describe any alternative approach.**

The establishment of a market threshold represents one way to balance the objective of fostering competition against the concerns related to inappropriate regulatory support of non-viable marketplaces. The Association generally endorses the 5% market share threshold, as it appears to encourage merit-based, market competition by protecting only those marketplaces that have demonstrated that they provide value to the industry. This is a positive change from the current system, which grants a regulatory subsidy (via a captive consumer base) to all new and existing marketplaces, regardless of whether they provide services of value to their potential users. In order to allow new entrants to succeed under this proposed regime, it is essential that dealers are not deterred from accessing the non-protected marketplaces. As such, it must be clear that where best price and execution are concerned, dealers should be able to route to a non-protected marketplace without penalty, where it offers the same or superior price or execution compared to protected marketplaces. This will be critical in fostering new

marketplaces that offer value-added services to the industry. Conversely, it is also critical that the application of the IROC best price and best execution rules do not effectively require dealers to access the non-protected markets.

The weighting of the 5% threshold based on volume and value is appropriate, as it will ensure that trading in low priced securities does not skew the averages to qualify a market as protected before it demonstrates its value.

It should be noted that certain members advocated the removal of the protected marketplace regulatory structure, so that all marketplaces compete on equal footing, as is the case in Europe under the MiFID regime. Under this regulatory structure, dealers would be responsible for ensuring best price and best execution as currently required under their regulatory obligations. Market forces would also support compliance, as in order to remain competitive, dealers would have to consistently obtain best price and execution for clients, who would otherwise take their business to competitors. The MiFID-like structure would also eliminate the confusion of having a two-tiered market, with protected and unprotected marketplaces.

**Question 2: Is a 5% percent market share threshold appropriate? If not, please indicate why.**

Although it is an arbitrary figure, the 5% market share threshold appears to be a reasonable starting point, as it will ensure that marketplaces have established a requisite degree of value to the industry before dealers are compelled to undertake the considerable effort and expense to connect and subscribe to their services.

**Question 3: Will the market share threshold as proposed help to ensure an appropriate degree of continued protection for displayed orders? In that regard, will the target of capturing at least 85-90% of volume and value of adjusted trades contribute to that objective?**

If the 5% market share threshold does in fact capture 85-90% of the volume and value of adjusted trades, this will represent an appropriate degree of protection for displayed orders. It is important, however, that this be continuously tracked to ensure that at least 85% of trading continues to be protected. If the number of protected orders falls below that level, further analysis will be required to determine if a readjustment of the threshold, or other measures, should be undertaken to ensure that an appropriate level of displayed orders are protected.

**Question 4: Will the market share threshold as proposed affect competition amongst marketplaces, both in relation to the current environment or for potential new entrants? Please explain your view.**

Although the establishment of a two-tiered marketplace structure may favour the protected marketplaces, the proposed threshold appears to be one that marketplaces offering services of value should be able to achieve. As such, this should encourage competition among marketplaces with a compelling value proposition. Marketplaces that do not have a service offering that will allow them to reach the 5% threshold without a regulatory subsidy should not be permitted to operate at the industry's expense.

**Question 5: Is it appropriate for a listing exchange that does not meet the market share threshold to be considered to be a protected market for the securities it lists? If not, why not?**

Granting a listing exchange protected market status for the securities it lists essentially negates the cost-saving and efficiencies of the Proposed Amendments, as it effectively requires dealers to connect and subscribe to exchanges regardless of whether they have achieved the 5% market share threshold. Once the time and costs of establishing a connection are expended, and the subscription fees are paid, it is unlikely routers will be programmed to only consider specific securities listed on that exchange. As such, unproven marketplaces will, for practical purposes, become protected markets without having established an appropriate value proposition to the industry. This subverts a significant element of the Proposed Amendments, and could result in marketplaces establishing an artificial listing business in order to support a trading business. Given that securities listed on an unprotected marketplace can trade on other venues, there is no need to require connection to the listing exchange where it has not reached the appropriate market share threshold. This also adds to the potential market complexity, as it would create a three-tier market structure, with unprotected, protected and listing markets, resulting in significant market confusion and inefficiency.

**Question 6: If the Proposed Amendments are approved, should an exchange be required to provide unbundled access to trading and market data for securities it lists and securities that it does not list? Please provide details.**

For the reasons articulated in Question 5 above, if an exchange is considered a protected market for the securities it lists, it should be required to provide unbundled access to trading and market data for those securities. A marketplace that has not demonstrated its value and earned its status through meeting the market share threshold should not be able to obtain the benefits of being a protected marketplace for elements of its business that are not protected.

**Question 7: What are your views on the time frames under consideration for the market share calculation and identification of 'protected market' status?**

Twelve months is a reasonable time frame to establish whether a market should be protected. This time frame will ensure that protected market status is not granted on the basis of factors or events that have short term effects on market share.

**Question 8: What allowances should be made for a new dealer that begins operations during the transitional notice period with respect to accessing a marketplace for OPR purposes that no longer meets the threshold?**

It is not appropriate to require a dealer to access a marketplace that will not be protected after a transition period. Given that significant time and cost commitments are required to connect, granting protected marketplace status to such entrants during this period is extremely inefficient and is inconsistent with the objective of not providing unproven marketplaces with captive clients.

**Question 9: Are there any implementation issues associated with the ‘protected market’ approach?**

There are a number of issues with respect to market data that must be considered in respect of this approach. For example, market data will have to be reconfigured to account for trades on protected versus non protected markets. In addition, order routers will also have to be programmed to account for marketplace status.

Market data providers may not approach this consistently, potentially creating confusion about quotes. (e.g.: Where is the midpoint, or what is the NBBO?)

**Question 10: What should the transition period be for the initial implementation of the threshold approach, if and when the Proposed Amendments are adopted, and why?**

The effective date and the transition period for the initial implementation of the threshold approach should take place as soon as possible in order to mitigate the current costs of the OPR, and increase the efficiency of the market.

**Locked and Crossed Markets**

**Question 11: Please provide your views on the proposed approach to locked and crossed markets. If you disagree, please describe an alternative approach.**

The proposed approach to locked and crossed markets is appropriate.

**Best Execution Obligations and Disclosure**

**Question 12: Is the guidance provided sufficient to provide clarity yet maintain flexibility for dealers? If not, what changes should be considered?**

It should be made clear that the NBBO in respect of dark pools pricing should only include protected market quotes, and that unprotected market quotes do not provide the basis for reference for other pricing mechanisms.

The guidance should also make it clear that in respect of best execution, dealers should have a plan in place for an ongoing review to determine if they should connect to unprotected markets, and that best execution on such markets will not be reviewed on a trade-by-trade basis.

**Question 13: Please provide your views on the proposed dealer disclosure to clients.**

We support disclosure at an appropriate level and in plain language geared toward retail investors. Clients should be provided with sufficient information to understand the best execution process, without having to wade through detailed and technical language. If, however, clients wish to obtain more detailed information about the best execution process, it would be appropriate to require dealers to provide this information upon request.

**Question 14: What should the transition period be for the proposed disclosure requirements, if and when the Proposed Amendments are adopted, and why?**

The transition period for the proposed disclosure should be consistent with the transition period for the Proposed Amendments in general.

**Consolidated Data**

**Question 15: Are changes to the consolidated data products provided by the IP needed if the amendments to OPR are implemented? If so, what changes are needed and how should they be implemented?**

The data provided by the IP must be adjusted to separate the protected marketplaces' data from the non-protected marketplace data.

**Trading Fees**

**Question 16: Please provide your views on the proposed trading fee caps as an interim measure. Please describe any proposed alternative.**

The proposed trading fee caps do not represent a reasonable improvement over the current fees charged by marketplaces, and should be reduced. Although the caps are consistent with those in the US, it should be noted that the average stock price in the US is approximately double the Canadian average stock price. As such, enacting a US-level trading fee cap effectively doubles the maximum relative trading fees.

It should be noted that the TMX Market on Open and Market on Close fees in Canada are 3-4 times those in international markets. These particular fees should also be brought more in line with such markets.

We also recommend that the cap be reduced for securities that are not interlisted on US marketplaces.

**Question 17: What should the transition period be for the proposed trading fee caps, if and when the Proposed Amendments are adopted, and why?**

The transition period for proposed trading fee caps should be consistent with the implementation of the Proposed Amendments. No additional time should be required.

**Prohibitions on Payment of Rebates by Marketplaces**

**Question 18: Is action with respect to the payment of rebates necessary? Why or why not?**

The payment of rebates raises a number of questions and issues. Proponents take the position that rebates increase liquidity by encouraging the posting of bids and offers on marketplaces. Detractors state that although rebates may be useful for trades in securities with limited liquidity, in practice, rebates are utilized primarily in highly liquid stock where additional liquidity is not needed, and that the posted quotes are often up for milliseconds and as such do not represent real liquidity. Opponents also are of the position that rebates may lead to suboptimal routing decisions based on which marketplaces offer rebates, rather than to those offering real liquidity.

**Question 19: What are your views on a pilot study for the prohibition of the payment of rebates? What issues might arise with the implementation of a pilot study and what steps could be taken to minimize these issues?**

A pilot study may assist in determining the costs and benefits relating to the use of rebates. The information can be used to develop regulation to refine the rebate model to achieve the intended outcomes.

**Question 20: Should all types or categories of securities be included in the pilot study (including interlisted securities)? Why or why not?**

Interlisted securities should be excluded from the pilot study as it may create disincentives to route to Canadian marketplaces during the study period, when US markets offer rebates.

**Question 21: When should the pilot study begin? Is it appropriate to wait a period of time after the implementation of any change to OPR or could the pilot start before or concurrent with the implementation of the OPR amendments (with a possible overlap between the implementation period for the OPR amendments and the pilot study period)? Why or why not?**

It is appropriate to undertake the pilot study 6-12 months after the implementation of the OPR amendments. If the initiatives are launched at the same time, it will be difficult to ascertain the effect of the changes to the OPR separate from the changes to the rebate model. If possible, the pilot study should correspond to a similar study that is expected to take place in the US.

**Question 22: What is an appropriate duration for the pilot study and why?**

Ideally, if the study takes place at the same time as the US study, the duration should be consistent. A 6-12 month duration is necessary to obtain enough data to draw credible conclusions from the study.

#### **Possible Credits for Market Makers**

**Question 23: If rebates were to be prohibited, would it be appropriate to continue to allow rebates to be paid to market makers and, if so, under what circumstances?**

Market makers provide an important service in the market when they are providing true liquidity. In order to ensure that they are providing true liquidity, they must be held to appropriate standards (such as those in the TSX Rules) to ensure they have an obligation to participate in the market and provide liquidity.

#### **Market Data Fees**

**Question 24: Will the implementation of a methodology for reviewing data fees adequately address the issues associated with data fees, or should other alternatives be considered? Please provide details regarding any alternative approach.**

Increasing and disproportionate market data costs have been among the most problematic unintended negative consequences that resulted from the OPR regulation. The IIAC has made a number of submissions to regulators on this issue in the past number of years. Our preferred approach, as outlined in our response to the CSA's request for comments on the market data fee issue in February 2013, is a cap on total market data fees, with marketplaces sharing revenue based on their value. In any event, a clear process for reviewing data fees is critical to address the issues. A consistent methodology will ensure that objective, consistent and trackable data is available for analysis, and will provide the basis for regulatory decisions.



**Question 25: Do you have concerns with respect to market data fees charged to non-professional data subscribers that securities regulatory authorities need to address? If so, how should the concerns be addressed?**

As noted by the CSA, the price of market data for non-professionals in Canada is significantly higher than in other jurisdictions. The current price structure has a material effect on access to information for retail investors by making certain data prohibitively costly, such that in some circumstances, it is not made available to investors using self-directed investment platforms. It should be noted that non-professionals use market data differently than professionals. Market data is not predominantly used for trading and accessing the information disseminated by all of the exchanges and ATs in real time, as professionals are required to do. More frequently, investors use the data for non-trading activities such as determining the value of their account and tracking realized and unrealized gains.

The increasing cost of data significantly impacts the investor experience, as they are limited in the amount of information to which they have access. For example, Canadian online brokerage firms do not provide retail investors with all the information available from all marketplaces, as the cost implications of doing so are non-economically feasible. This puts the investor in a disadvantaged position in relation to professionals, and retail investors in other jurisdictions where this data is available at a fraction of the cost. In addition, individual users can be charged numerous times for the same market data, as the marketplaces define users on a per application basis, rather than a per individual basis. For example, a client accessing TMX quotes on a mobile platform and a desktop would be considered two people and charged twice.

As such, we support the imposition of a cap on non-professional market data fees. We believe the cap should more or less mirror the rates charged in the US, which are approximately 2-5% of the fees charged for access to the same data by professional users.

**Alternative Approaches**

**Question 26: Is modifying OPR by introducing a threshold, and at the same time dealing with trading fees and data fees, an appropriate approach to address the issues raised? If not, please describe your alternative approach in detail.**

The introduction of a threshold, fee caps and market data regulation is likely to address the majority of problems related to fees created by the OPR, provided that the threshold, caps and methodology are calibrated properly. Although the proposed calibration may require some adjustment as the impacts are demonstrated in practice, the underlying approach appears sound in respect of how it addresses the current problems.

**Question 27: What is the expected impact of the Proposed Approach on you, your organization or your clients? If applicable to you, how would the Proposed Approach impact your costs?**

It is difficult to quantify the expected impact of the Proposed Approach at this stage, as certain costs would be avoided as result of the inception of marketplaces that will choose not to launch due to the 5% threshold. At this point, savings related to the proposed fee caps are likely to be minimal, as the fee caps are relatively high. It is also difficult to anticipate the savings related to market data until the formula is in place and applied to the relevant marketplaces.

**Question 28: Is the Proposed Approach an effective way, relative to the other approaches described, to support a competitive market environment that encourages innovation by marketplaces? Please explain your view.**

Under the Proposed Approach, unlike the existing market structure, marketplaces will have to offer real innovation in order to provide a clear value proposition to earn market share. Those that have a unique and useful product will attract clients without a regulatory crutch of protected market status, and will provide the market with compelling and real competition.

### **Membership and Connectivity Fees**

**Question 29: Considering the Proposed Approach, is it necessary to take additional steps to regulate membership and connectivity fees charged by marketplaces? If so, why, and if not, why not?**

Given that it is necessary for dealers to connect to protected marketplaces (and in some circumstances related to best execution obligations, non-protected marketplaces), it is important that membership and connectivity fees be subject to regulation. The issue of captive customers also applies to membership and connectivity fees, as dealers must connect to all protected marketplaces. Marketplaces should not be able to take advantage of their protected status to charge excessive fees to clients that are required by regulation to use their services. One means of addressing this may be to require marketplaces to subsidize trading fees up to a standard connectivity cost for a certain amount of trades per month.

In addition, marketplaces should have restrictions on upgrades and changes that significantly impact the wider industry. For instance, marketplaces should be required to make a case in respect of timing and costs prior to making major changes that will impact a significant number of industry participants.

### **Marketplace Liability**

**Question 30: Considering the Proposed Approach, is it necessary to take additional steps at this time to address issues relating to marketplace liability? If so, why, and if not, why not?**

Given that dealers are currently captive consumers, they have very little negotiating power in respect of the terms of their contracts with marketplaces. In particular, terms related to indemnity, liability and consent to changes, which are regarded by dealers as commercially unreasonable and would not be accepted in a free market, have been imposed on dealers under the OPR framework. For example, we understand in many cases most of the commercial terms of the subscriber agreement are incorporated by reference from the marketplaces' Trading Policy Manual. These terms, which include the limitation of the marketplace's liability, can be changed at the sole discretion of marketplace with no requirement for notification. In addition, the limitation of liability, and indemnification provisions disclaim any liability for any negligent, reckless or willful acts or omissions of the marketplace. The dealers are unaware of limitation of liability provisions in agreements for the provision of similar services that exclude liability for such acts. Similarly, indemnification provisions in such agreements typically include a carve-out for such acts. There are also provisions requiring dealers to have procedures in place to monitor changes to the Trading Policy Manual. In accordance with section 6(3) of National Instrument 23-101 – Trading Rules ("NI 23-101"), dealers require 45 days advance notice of any changes to the Trading Policy Manual. Marketplaces should have to covenant that they will communicate changes to the dealers.

These issues should be addressed in the Proposed Amendments. We recommend the inclusion of requirements that information security obligations be bilateral, and that marketplaces should not be permitted to limit their liability for the use and/or failure of the trading system in the event of a reckless or willful act or omission. Marketplaces should also be required to have a clear Service Level Agreement that provides target market up-times, down-times and recovery times and business continuity plans and scenarios.

One suggested approach is to consider whether marketplaces should be required to submit their subscriber agreements to the OSC when applying for recognition, such that the industry would be able to comment on the agreements to the OSC – and provide input on whether the terms are commercially reasonable.

**Data Fee Review Methodology**

In establishing a context for the regulation of market data fees, there are certain key principles that should frame the structure of the rules. Market data should be readily accessible and provide meaningful information. An indication of whether the data provided by a marketplace is meaningful can be determined by whether it reflects actual trades at or close to the BBO more often than not. One way to measure this may be to use criteria similar to the TMX Market Maker program to establish the value of the

information. Factors that should be considered in determining the value of a marketplace's data is its ability to contribute to the overall market in terms of creating liquidity, depth and continuity. Specifically, the TMX considers: spread maintenance, which is the market maker's ability to call a 2-sided market; the participation of market makers in their security of responsibility; and liquidity which evaluates whether market makers are lining the book with reasonable depth. If marketplaces could be evaluated using similar criteria as market makers, it would help determine if they are contributing to market quality.

Any method chosen to evaluate the value of market data must be tested to determine if it achieves its objectives, while avoiding unintended consequences. Our responses to the questions below represent educated guesses as to how the proposed methodologies might work, however, it is critical to test the methodologies with actual data to check the outcomes against the objectives. We recommend that a working group with technically skilled individuals (including those on MRAC, MCSA and marketplaces) be formed to develop scenarios and test the models using actual data to determine how the models work in practice.

**Question 31: Taking into consideration how these pre-trade metrics will be used within the various ranking models, are these reasonable proxies for assessing a marketplace's contribution to price and size discovery? Are there other metrics we should consider? Please provide details.**

The pre-trade metrics discussed in the Notice all appear to provide reasonable proxies for assessing a marketplace's contribution to price and size discovery, however, certain metrics may be more appropriate than others in respect of measuring the value of the marketplace to the industry overall. In order to state conclusively what metrics would provide the most relevant measurements, it would be necessary to test the formulas against real data to determine how the marketplaces are valued for the purposes of their market data.

As a general approach, the IIAC favours one that is based on value, rather than volume, as it provides an indication of where trades actually take place.

**Question 32: Are the pre-trade metrics described appropriate for a marketplace that predominantly trades less liquid securities? Please indicate and describe what pre-trade metrics would be appropriate to use for such a marketplace.**

The pre-trade metrics described in item 1 (Percent of BBO) and 2 (Percent of Best Spread) would potentially favour a marketplace that trades in less liquid securities. This may not lead to an appropriate measure of the value of market data as the emphasis on volume should not take precedence over a measure of trades that are actually completed.

**Question 33: Taking into consideration how these post-trade metrics will be used within the various ranking models, are these reasonable proxies for marketplace liquidity? Are there other metrics we should consider? Please provide details.**

Although the post-trade metrics also provide reasonable proxies for marketplace liquidity, we believe metrics emphasizing value (eg: 3 – percent of each marketplace’s dollar volume and 4 – percent of square root dollar volume for each trade) provide a more meaningful outcome as to true liquidity in the market. The metrics emphasizing marketplace volume and number of trades could easily be manipulated to affect outcomes, and may incent a type of trading involving a higher number of smaller trades. In addition, option 5 – Scope of trading on each marketplace – could easily be manipulated to result in certain outcomes.

**Question 34: Are the post-trade metrics appropriate for a marketplace that predominantly trades less liquid securities? Please indicate and describe any additional post-trade metrics would be appropriate to use for such a marketplace.**

Option 5 – Scope of trading on each marketplace would favour marketplaces that predominantly trade less liquid securities, however, as noted above, it could be easily manipulated to affect outcomes and as such may not reflect the value of the marketplace to the industry.

**Question 35: Are the ranking models described appropriate for ranking a marketplaces’ contribution to price discovery and liquidity? Are there other ranking methods we should consider? Please provide details.**

Each model would measure the contribution to price discovery and liquidity in different ways and therefore, would lead to different outcomes. Whether the outcomes are appropriate depends on what participants think is important to emphasize. We believe that model 1 – SIP Value provides the best measure of price discovery and liquidity, as it takes into account the volume behind the quote, and discounts the value of very large trades that may distort the actual value of the marketplace in general. Given that model 2 – SIP Equal does not distinguish between stocks that trade often and those that rarely trade, it may result in an overemphasis of markets that trade in illiquid securities.

**Question 36: If you had to choose one of the three ranking methods described, which method would you chose and why?**

It is important for marketplaces to demonstrate value beyond just providing quotes, but actually having trades execute on that market. As such, Model 1 – SIP Value appears to be the most relevant.

**Question 37: Please provide your views on the reasonableness of the two approaches for establishing an appropriate reference amount for data fees to be used in applying the data fee review methodology?**

In order to reflect the international nature of markets, it is important to measure marketplace value vis a vis international standards. However, it is also important to ensure the comparisons are relevant and that the differences in size and structure of markets are taken into account when comparisons are undertaken. As such, it should be clear what international markets the Canadian marketplaces will be measured against.

**Question 38: What other options should we consider for identifying an appropriate reference amount? Please provide details.**

No feedback was provided for this question.

**Question 39: How frequently should any selected reference amount for data fees be reviewed for their continued usefulness?**

Data fees should be reviewed annually, and there should be some discretion to for an interim review if there is a significant shift in market structure or market share among marketplaces.

The IIAC acknowledges the significant effort that resulted in this comprehensive re-examination of the OPR. The wide scope and interdependencies of the issues make it very difficult to propose wholesale changes in one area without creating unintended consequences in another. Given the different, and often conflicting interests of various market participants, developing a proposal that will address the needs and wishes of all participants is not possible. However, subject to our comments, we believe the CSA has advanced proposals that represent a significant improvement over the current situation and will work for the industry in general.

Thank you for considering our comments. If you have any questions, please do not hesitate to contact me.

Yours sincerely,



Susan Copland