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Re: Proposed Amendments to National Instrument 23-101 *Trading Rules (the "Proposed Amendments"*) and IIROC Notice 12-0124 Proposed Provisions Respecting the Order Protection Rule

Dear Mesdames and Sirs,

We write today on behalf of the institutional division of RBC Dominion Securities Inc. ("RBCDS") in response to the above noted requests for comment. We are pleased to provide comment on the critical issues raised by the Proposed Ammendments.

Before offering feedback on the specific areas of inquiry posed by Staff, we feel it is important to offer general comments on the current state of competition in equity trading in Canada. The value of competition between commercial entities has long been viewed as a key part of the engine that underpins employment, economic growth and prosperity. Yet, the widely accepted merits of competition can have negative exceptions – quite often these arise as the unintended consequence of entirely well-intended government or regulatory intervention.[1] We believe such is the case with OPR as it exists today.

In less complex industries commercial entities compete through features, distribution channels, geographic scope and cost of their products and services. Consumers, on the other hand, are free to choose among offerings or seek out substitutes to maximize their utility. In these cases regulations focus on fundamental and unambiguous issues such

[1] "Is competition always good?", Maruice E. Stucke, Vol. 1, No.1 (2013), Journal of Antitrust Enforcement.

as labour, environmental, safety standards and the like. But does this simple notion of competition apply to the modern day business of operating an equity trading marketplace? Clearly not.

Today, the line between the suppliers of a marketplace's core value proposition (liquidity) and its consumers (investors) is hopelessly blurred. Under the protection of OPR, trading venues generally pass a subsidy to intermediaries from investors who are crowded out from obtaining passive fills and often are, as such, captive takers of liquidity. A venue's "cut" of typical trading fees is a relatively small component (10-15%) of the total cost to take. Considering these facts, the economics of the maker-taker "pass-through" bares no resemblance to traditional competition centred on consumer choice.

What innovation has OPR brought? Pricing novelties such as inverted 'taker-maker' pricing in our view fail to live up to the term '*innovation*' in any meaningful way. Setting this aside, the focus of most marketplace competition is on speed. On the trading side, TMX's recent move to Quantum XA has surely cost the street tens of millions of dollars to implement and code to – yet the benefits of this technology 'upgrade' accrues to speed-oriented intermediaries – not investors. Likewise, a growing portion of TMX's business revenues are won providing various services in the form of co-location, proprietary data feeds, and now – exclusive high speed microwave data service between the co-location facility that houses its matching engines in Markham and US equity marketplaces located in New Jersey.

In offering up such services, marketplaces argue they are 'fair' – fair of course in the sense that any party *could* choose to subscribe to them. This argument conveniently ignores the inherent bias in their natural use and to whom they directly cater. It also overlooks that the utility gained from these services is maximized in combination. Finally, there is the speed-centric arms race, self-similar behaviour amongst intermediaries it encourages and the impact on the fairness of trading for investors. Setting all of these critical issues aside – legally speaking – it can still be argued that these services are offered 'fairly'.

Marketplaces of course claim intermediaries use such tools to service investors by narrowing spreads. Of course we and others have long maintained such thinking ignores the contradiction in the needs, nature and motivation of long-term investors and that of intermediaries with <u>no other rational motivation or incentive</u> than to maximize value extraction based on their costly preferential view of and access to markets. This again calls into question the simplistic view of competition where liquidity is the product that investors consume and spread is the cost of goods sold. If only it were so simple.

Declining trade sizes, heightened cancellation rates, the unquestionably material proportion of liquidity consuming trades found for HFTs in most studies, our research showing a clear and permanent increase in intraday price volatility taking hold from 2001-2008, estimates of HFT profitability and the link between these profits and volatility – all offer a wealth of evidence suggesting that price volatility has a significant impact on investor cost. This constitutes a significant underlying and difficult to measure, let alone constrain, cost to today's market structure. It also has implications for the perceptions of both fairness and efficiency of today's equity markets.

The question at hand for us therefore becomes can competition be improved and made to work in the broad interest of investors and issuers? We are sympathetic to those who

argue that a single industry utility model might be best for equity markets. Indeed, the underlying message of the proposed amendments seems to be an implicit acknowledgement that the competitive behaviour spurred by OPR has contributed to competition that is in many ways contrary to the public interest. Yet, it remains clear the CSA hopes it can collectively find a way to foster productive behaviour with less negative side effects in the context of competition. For our part we absolutely share this hope.

We understand those who argue that a competitive framework founded in a "best ex" regime would be best for markets. The prevalence of dark pools and fragmentation in Europe gives us pause here – and we agree with the regulatory view that Canadian market participants have broadly come to value the notion of order protection. Ultimately, this leads us to the view that the CSA should proceed carefully – which would be inconsistent with a wholesale move to a best ex regime. As such, we are supportive of efforts to seek a better balance while retaining the notion of order protection. With this goal in mind, we now offer thoughts on key areas of inquiry in the Request for Comment.

Implementation of Market Share Thresholds

The amendments propose to establish thresholds for which marketplaces would need to meet and maintain trading activity relative to other marketplaces in order to be deemed protected under NI 23-101. While such a mechanism could be an effective part of a regulatory response to address the unintended consequences associated with OPR, we are concerned that more consideration needs to be given to the specifics and implications of any such solution.

It should be noted that there are a variety of potential problems of consistency between such a regime and UMIR – in particular as it relates to rules around best execution. Moreover, as we will outline later, there are a variety of other actions the CSA can take which do not entail managing the complexities of a partially protected regime. Having noted these caveats, we will nevertheless offer thoughts on how the proposed threshold mechanism can be improved upon.

The proposal indicates that trading activity which would be considered for purposes of measuring thresholds would incorporate continuous auction trades involving passive displayed orders and will exclude crosses, dark orders, opening/closing calls, special terms, etc. We believe that this universe of trading activity is generally appropriate for this stated purpose.

The two metrics proposed to be considered in determination of the thresholds are volume and value traded. While we agree that these two underlying factors are appropriate for consideration of relevant market share metrics, we disagree with how the proposal intends to utilize them in practice. Our concerns with this are as follows:

- **Weighted Combination of Volume and Value** – The manner of equally weighting volume and value is arbitrary. While combining these measures does increase the difficulty for parties to "game" a pure volume weighted measure, we disagree with the assessment of Staff that volume is "most related to our objective to protect passive orders". In fact, we would argue that value traded for many participants would be deemed a more appropriate stand-alone measure as it captures the notional value of secondary market

trading activity. By contrast volume is a statistic that the proposal itself acknowledges can be manipulated by generating skewed activity in low priced securities – inherently making this metric more gameable. This vulnerability is clearly evidenced by TSXV representing 23.33% of volume yet only 0.81% of value traded in 2013.

- **5% Threshold** – The weighted 5% volume and value threshold appears arbitrary. We believe that 5% may be too high – particularly considering that the outcome of the pro-forma analysis would remain near identical (with the exception of Venture) if the threshold was set at 3%. In fact, we believe that a lower threshold could actually be more effective – provided that volume and value are considered independently.

- **Annual measurement** – We believe that the proposal to only consider metrics annually is inconsistent with the goal of supporting competition and innovation. Expecting any new marketplace to operate for as much as 12 months in order to meet thresholds plus a notice period before protection is achieved is in our view an unreasonable barrier. Such a barrier is likely to reduce the responsiveness of incumbent players to the needs of participants.

For a threshold-based regime to be effective it needs to balance the risk of manipulation or gaming against the goal of harnessing competition in furtherance of the public interest. In discussions with Staff we have been left with the impression that the complexity of the mechanism was a primary concern. On the contrary, given the importance of ensuring the mechanism's effectiveness, we think that simplicity should be a secondary goal. Necessary complexities will ultimately be a matter for marketplace operators, industry participants, regulators and professionals to consider. By contrast, we believe end investors or the general investment public are far less interested in these details than in knowing an effective regime is in place that protects the public interest.

Based on the above, we would offer the following recommendations to improve the effectiveness of the threshold regime:

1. **Consider volume and value independently** – In our view a marketplace should need to reach a threshold of volume and value jointly but independently. As we have said, we believe value traded is important to consider as a stand-alone measure of relevance. Any marketplace that reaches both a volume and value threshold independently will have demonstrated a diversity of appeal which truly warrants protection. We would further underscore that disaggregating the two measures will more effectively hamper gaming as any such efforts would need to manipulate both statistics independently. Under the existing approach efforts could be focused solely on volume which could easily overpower any moderating impact offered by the value measure – rendering its consideration irrelevant.[2]

2. **Lower the threshold** – While we have argued for volume and value to be considered independently, we believe that a more conservative 3% would be

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[2] As it relates to TSXV, CSE and other listing markets we believe that primary listing markets should always be considered protected for their listed securities.

reasonable as a starting point on these measures. We support periodic review of this threshold as needed.

3. **More frequent measurement/review** – We believe an annual measurement will have a negative impact on competition in favor of incumbent protected marketplaces. To strike a better balance such measurements should be conducted more frequently – perhaps quarterly rather than annually. We believe that the concerns expressed in the proposal around dealer/vendor costs and investor confusion[3] can be addressed through other mechanisms (see 4. below) and must be weighed against the ongoing value of competition. On this basis, we believe that three months of trading data would constitute more than a reasonable sample period when measured as we propose.

4. **Implement a 'buffer zone' to address turnover** – To address the potential concern for a marketplace to achieve protection and then lose it we would propose a lower yet meaningful threshold on both volume and value for a marketplace to retain protection. We believe that falling below half to two-thirds of our proposed measure (3%) to attain protection (1.5-2.0%) on *either measure* would represent a meaningful decline in the relevance of a marketplace to warrant exclusion. As a further preventative measure we would recommend that any marketplace that attains the threshold for protection should retain that protection for a minimum of 12 months. Thereafter, its ongoing status could be considered quarterly.

We believe our alternative proposals, while involving minimal additional complexity (primarily for regulators to manage) will be less prone to gaming, more effective at identifying marketplaces with diverse rather than niche relevance and more responsive to accommodate emergent marketplaces in the OPR regime. By comparison the proposal of the CSA while somewhat less complex would be more gameable, would favour incumbents and unduly discourage competition.

It should also be strongly emphasized that re-mandating the role of the information processor will be critical to support competition in the proposed regime. Specifically, we advocate for the development of a quality (fast, robust, reliable) US-style SIP model which incorporates <u>all</u> marketplaces (protected and unprotected). Failure to incorporate coverage of unprotected marketplaces under the mandate of the information processor will hamper competition and therefore favour incumbent marketplaces.

Implications of Protected/Unprotected Regime for UMIR and National Instruments

We strongly believe that dealers will need to have latitude to retain flexibility and discretion in their approach to best execution under the contemplated regime. We believe greater transparency and ongoing documentation of best execution policies should extend to the rationale behind decisions to connect or not connect to visible but unprotected markets. That being said, we maintain that regulators should not be prescriptive as to the factors that a dealer takes into consideration in this decision making process.

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[3] III. A. 1. iii) "Process for setting the market share threshold and identifying the protected markets"

We specifically share concerns with our colleagues on the street in relation to proposed changes to UMIR 5.3. While the spirit of these changes attempts to address specific order-by-order cases of intentionally trading ahead of client orders by placing such orders on an unprotected marketplace, we worry that the practical application of the language would be far broader. There is a strong likelihood that interpretation of this amendment could lead to a significant compliance burden which will strongly discourage natural client order flow from being rested on new marketplaces – entirely contrary to the goal of fostering competition. In order for a partially protected regime to be effective these concerns must be addressed.

The business models, clientele, cost structure and securities universe of different dealers can be expected to translate into both obvious and subtle differences in the interpretation of the relevant factors that impact routing decisions. As such, we believe that the determination of and weight attached to these factors should be left to the discretion of each dealer when deciding to connect or route orders to an unprotected market. To be clear, the same discretion should be left to dealers as it relates to the decision to maintain or cease connectivity to a given unprotected marketplace.

We agree with the spirit of proposed Section 4.4 of NI 23-101. It has been our ongoing view that greater transparency of broker routing practices is needed. We would however highlight that routing decisions can reasonably vary upon many dimensions, including:

- by client based not only on their unique business models but also on commercial terms, trading styles and decisions which are unique even within general classes of clients;

- by security-specific liquidity/market structure characteristics as well as overall market structure conditions – factors which impact both the likelihood of receiving a fill and market impact associated with a fill;

- by execution strategy – both automated algorithmic orders and trader managed orders may dictate the use of different and varied routing strategies – these decisions can involve either trader discretion or the need to randomize tactics to avoid detection in today's marketplace.

Given the existence of these qualitative factors we would like to confirm our interpretation that language designed to broadly encompass the impact of such general considerations on the dealer's routing practices will be acceptable in fulfillment of its obligations under the proposed Section 4.4.

We agree with Staff that clear regulatory guidance will be critical to support any move to a regime where some marketplaces are protected and others are not. Specifically, there should be consistency of treatment under UMIR for "best" and "better" priced orders with that of best price under OPR. The proposal that the locked and crossed market provisions should be aligned to only apply to protected markets under the new regime is reasonable. Likewise, we agree with the planned prohibition on the entry of orders on an unprotected market that would either lock a protected book or further a lock created by the quote of a protected market locking/crossing an unprotected quote.

Trading Fee Proposal

We strongly support any initiative that seeks to establish greater control over the practice of payment of rebates in equity markets. It is our belief that this practice, while surely contributing to narrower displayed spreads, has nevertheless resulted in a variety of economic externalities (fragmentation, fading liquidity, increased intraday price volatility) that negatively impact market efficiency and the cost of accessing secondary markets for natural investors. As such, we support the CSA's intent to review the practice in the context of Canadian equity markets.

In our view the trading fee proposal absent externalities holds arguably the greatest promise of addressing many of the issues associated with modern market structure. As such, it should come as little surprise that the ability of regulators to bring about meaningful change will be fraught with difficulties.

First, for any pilot study to be successful there are several key factors that must be carefully considered. Among them:

- **Length** – it is our view that any pilot study should run for a minimum of one year and arguably as long as two years to allow complex changes in liquidity patterns to take hold. A short-term study runs the risk of failure to allow these changes to take place (allowing new modes of liquidity to take hold) and would undoubtedly be vulnerable to gaming.

- **Scope** – the study should incorporate a broad sample of various securities including both corporates, ETFs, preferred shares, etc. to address the commonly noted tendency for maker-taker to attract intermediation where it is not needed (where underlying liquidity is already present) and failing to attract it where it is (in less fundamentally liquid names).

- **Metrics** – for the study to glean useful information a variety of metrics should be considered. The academic community and practitioners on both sides of the debate should be consulted to assemble metrics that examine market quality through all relevant lenses. We would submit that the marginal cost of examining additional metrics will be small. By contrast, the risk of failing to capture metrics deemed relevant by various participants will undermine the completeness and therefore legitimacy of the study.

Also, as has been widely discussed in the industry over the past three months, inclusion of Canadian names interlisted in the United States will be problematic without the cooperation of the SEC. We have advocated that the CSA explore the possibility of a joint pilot study on Canadian interlisted names with the SEC. In the absence of such multi-jurisdictional cooperation, we cannot advocate that the CSA proceed without cooperation from south of the border. One point on which there appears to be little disagreement – doing so would only result in Canada ceding observable market share[4] in its household names to the US Notwithstanding this difficulty we believe the CSA should look to show leadership on this issue by proceeding on non-interlisted names as

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[4] Albeit driven by excess intermediation, the fact remains that overseas investors deciding to trade a stock in Canada or the United Sates will rarely focus on such nuances. Ultimately here the concern is that of optics.

soon as possible. Meanwhile, we encourage the CSA to continue to actively pursue a joint pilot study with their colleagues to the south.

Staff is also seeking comment on the implementation of a fee cap of 30 mils in Canada. While some argue that the average share price in Canada being near half of that in the US supports lowering rebates, the fact remains that implementation of a lower fee cap for interlisted securities risks market share loss in these names. As such, at this time we can only advocate implementing a matching cap for this particular universe.

For non-interlisted securities, we generally would advocate consistency with interlisted names – retaining the cap at 30 mils. Our reasoning here would be to avoid unnecessary marketplace confusion on fees. That said, we cannot overemphasize enough the view that maker-taker introduces many agency conflicts, contributes to unnecessary fragmentation and should ultimately be eliminated. We are confident that a properly conducted pilot study will bare these facts out.

On the issue of payment of rebates or other financial incentives to market makers, we believe that such practices can be a component of a successful market maker program – provided these benefits come with meaningful obligations. Marketplaces should have leeway to offer such incentives, however we believe transparency and careful oversight of such programs is necessary. We also believe these arrangements should involve a single active responsible market maker per security – ideally with necessary backup arrangements. Finally, financial incentives should be linked to overall market maker performance metrics rather than directly to engagement in individual trades.

Marketplace Liability

We support the notion of enshrining standards for marketplace liability into subscriber agreements for all marketplaces. Today participants are entirely at the mercy of all marketplaces under OPR and the only thing that the proposed amendments would accomplish would be to limit that list. We see the lack of marketplace liability as negatively impacting the behaviour of all marketplaces – large and small. As such, we do not believe that the proposed amendments address this fundamental issue.

The policy goal of marketplace liability should be to provide a meaningful disincentive for both careless changes to marketplace ecosystems and the implementation of systems without appropriate safeguards. Likewise, marketplaces should not be in a position to unilaterally impose changes to their trading policies (which most marketplaces incorporate in their subscriber agreements by reference) without proper notification and agreement to/by all participants. Such changes should be subject to reasonable regulatory oversight and, if deemed material, to public comment. Marketplaces should also have to comply with a standardized Service Level Agreement establishing target market up times, recovery times and proper business continuity planning.

Overall, we believe the CSA should seek industry input specifically related to marketplace liability standards. As a general view, to support rather than hamper competition such standards would need to reflect factors such as protected/unprotected status, market share and the revenues of each marketplace.

Marketplace Technology Changes

It is our view that any marketplace technology changes that result in a substantial technology change management effort for participants should be subject to regulatory oversight and public comment under NI 21-101. Likewise, any optional services that could reasonably be expected to impact the equitability of either market access (order entry) or market visibility (through market data) should be subject to regulatory oversight and public comment under the same instrument. Regulators should seek to clearly understand the need/urgency that gives rise to the technology change or the innovation that it brings. Particularly with the case of the latter, it is our belief that public comment is necessary to provide an opportunity to assess the net benefit of any proposed changes in light of the associated costs for participants. It is our view that such technology change proposals should (at a minimum) be required to state the anticipated benefits of and impact on intermediaries, retail investors, institutional investors and issuers.

Market Data Proposals

Further to our letter of February 11, 2013 in response to CSA Staff Consultation Paper 21-401 (Real Time Market Data fees), we believe that the cost of Canadian market data is too high, fees are not subject to a sufficient amount of competitive forces to keep rates at a reasonable level, some marketplaces continue to charge a disproportionate amount for market data relative to their market share and participants have been held captive to fees charged for market data in order to meet regulatory obligations.

In general, the proposal still does not address the issue of the existing cost of market data. In fact, the proposed approach actually discourages new entrants. On this basis, we believe that the CSA should establish overall street caps on core (Level 1) market data fees. We would recommend that this cap be indexed to the baseline inflation as measured by CPI.

The revenue stream received by the marketplaces for selling core market data is often supported by other ancillary services such as co-location services, network services, quotation services, end of day products, etc. which compete with data providers (such as Bloomberg or Thomson Reuters). This obfuscates the true cost of delivering core market data. We note that newer marketplaces operate with minimal staff, having outsourced many core functions (and thus have a cost advantage against established incumbents). In fact, the BATS exchange in the US famously concluded that their cost structure was so efficient that they had no need to charge for market data (BATS recently introduced some modest fixed fees).

Through our affiliate, RBC Direct Investing, RBC provides realtime market data to non-professional data subscribers. While these fees have remained fairly stable in Canada, as the CSA rightly concludes, the cost of data for non-professionals is significantly higher in Canada (as a percentage of professional fees) than in other jurisdictions.

We support caps on the maximum percentage (of professional fees) that can be charged to non-professionals. It should be noted that a large number of data subscribers pay for non-professional data on a per-query (per-quote basis). As an example, the TSX charges $0.01/quote to a maximum capped amount of $6 per month for snapshot Level

1 data for non-professionals. We propose monitoring and adjusting the capped amount ($6 in this case) rather than the per-query rates.

We also believe a solution to address market data "unit of count" is required. Today, the TSX definition of unit of count is rooted in an old term, namely "interrogation device" (which dates back to green screen technology). In plain English, the policy requires consumer firms to report and pay for each instance of TSX data used by the same consumer (RBC DS, as an example pays in one case 6 times for the same TSX data for the same employee given the data is made available across several different applications). Exchanges globally have responded to the changing use of their data and adopted new policies for net reporting and paying for data (NYSE's implementation is called MISU) that does not discriminate against firms that choose to use multiple technology inputs for a single employee. We would encourage regulatory boundaries that prevent marketplaces from charging for data used by the same employees multiple times (so long as controls can satisfy that indeed the same employee benefits).

We also note the lack of a commercial solution to address non-professional access to the TMX IP (consolidated data through the information processor). Today, firms providing data to non-professionals typically subscribe to the TSX and TSX Venture feeds only. As such, they are doing a disservice to investors by showing less than two-thirds of the market. Complicating matters, alternative marketplaces do not necessarily have a cost model for per-query access to their data. Realistically, the per-query model lends itself towards retrieving quotations from one market, not multiple markets. We suggest reviewing non-professional fees in the context of the TMX IP, whereby non-professional participants could receive a fully consolidated quote at a fixed price.

We are in support of transparent metrics to establish each marketplace's contributions to pre and post trade activities, thus leading to an approach of distribution of fees. As has been correctly concluded in the evolution of the US SIP model, one model alone is not enough to balance out potential bias (and discourage marketplaces from participating in activities that may skew results). As such, a thoughtful combination of pre and post trade metrics will help to drive a view that should be relatively free of distortion. We expect the marketplaces will have more specific views on which metrics are most appropriate.

The two approaches suggested by the CSA to assign an estimated fee or fee range are problematic:

> *Domestic reference* – This approach effectively ratifies current fees charged by marketplaces as being "fair and reasonable" as a starting point. We disagree with this approach.
>
> *International reference* – While this approach looks beyond the domestic marketplaces, it is difficult to draw a supportable comparison. Looking to the US and Europe, labour costs and corporate taxes traditionally are higher than in Canada. As such, the cost base of a London-based or New York-based marketplace would be expected to be higher than a Canadian marketplace. That said, the sheer number of market data subscribers to these markets are also higher to support a higher cost base (leading to lower per-unit costs). International marketplaces may also be under different regulatory regimes that expose them to additional overheads. While useful to understand the price

ranges of international markets, we do not believe this should be a primary factor in setting appropriate prices in the Canadian market.

Based on industry estimates, gross margins on market data fees are between 50 and 100 percent, which continues to suggest the lack of competition protects excessive margins. Marketplaces enjoying order protection should be in a position to generate fair (but not excessive) returns for their shareholders.

We find it interesting that, to date, there has been no focus on the actual cost of disseminating market data. Again, how is it that BATS are able to charge minimal data fees yet their daily volumes are significantly higher than the largest of the Canadian exchanges? This example suggests inefficiencies in the cost structure in the Canadian markets or excessive profits are the root cause of the high cost of market data.

We believe the "reference amount" should be driven in part by considering the cost of distributing the data (with a modest margin applied). We believe the appropriate data points could be obtained by consulting industry experts or even solution providers. The CTA (operating one of the US SIPs) makes available financials that could potentially be used as inputs to understanding the true cost of distribution of market data. Both the operating costs of the technology as well as staffing to support the function (administration, etc) should be considered.

The US SIP model benefits from a centralized technology infrastructure to consolidate quotes and a centralized administration team. In addition to disparate prices, today each marketplace maintains a unique set of policies, reporting obligations, billing systems, audit teams, etc. The administration overhead on data consumers is significant, as is the cost to the industry by having duplicative functions at each marketplace.

We appreciate that the CSA is concerned with solutions that have less of a legislative impact, however we believe the ultimate solution is to develop a true US-style SIP. There are numerous benefits to this model:

- full view of the entire Canadian marketplace (without the high price of subscribing to all markets as a disincentive) both domestically and internationally;
- an opportunity for new emerging marketplaces to be visible to all Canadian data consumers;
- simplification for data vendors to adopt one type of data feed rather than having to maintain multiple interfaces to multiple marketplaces;
- potentially increased adoption (and better understanding) internationally with a single data service;
- consistent data use policies across all marketplaces;
- a centralized administration team, reducing both costs to the industry that exist today due to duplication and also administrative overhead incurred by firms (maintaining bespoke documentation for each marketplace, multiple invoices, reporting of data use across multiple exchanges, etc).

We understand the CTA receives confidential financial statements from the marketplaces contributing to the consolidated tape to support the costs of distribution. The reference amount could be derived through similar means, while allocation of the revenue to the individual marketplaces would be based on the pre and post-trade metrics identified earlier.

We suggest the reference amount be revisited on an annual basis. In our proposed model, the marketplaces would provide their financial statements on an annual basis for review. The revenue allocation models should be reviewed every two years, while the payments from the SIP to the marketplaces should be based on monthly metrics using the model in force at the time.

Over the course of the past few years, we have noted global marketplaces introducing complex licensing models above and beyond traditional end user fees. These licensing models include data licenses based on activity (algo/black box trading, number of servers receiving data, etc) which are often subject to interpretation or pose administrative or technical concerns. Improper implementation of these policies will ultimately lead to disputes between the marketplaces and end consumers of the data. Further, many of these policies result in an increase in fees and thus should be properly filed as an application with the appropriate regulator(s).

We appreciate that the CSA has expressed concern that comments received will be focused on commercial issues, however experience in the US has shown that some new models (outside of simple price increases) have been introduced without understanding whether marketplace participants can practically adhere to the reporting obligations. As an example, the notion of counting physical number of servers "processing" data can lead to subjective judgement and conflict during data audits.

To balance the need for an expeditious process, ensure new policies can be practically adhered to and well understood and provide regulatory oversight, we propose formation of a review committee that includes both regulatory and data consumer representation. There is precedence in the US market with the CTA committee, which includes representation from both exchanges and consumers.

As discussed in the proposal, the price of market data for non-professionals in Canada is meaningfully higher than in other jurisdictions. The current price of such market data services has a negative impact on access to information for retail investors. This impacts their ability not only to execute trading decisions but also to determine their account value and profit/loss associated with positions they have assumed.

Connectivity and Other Ancillary Fees

Today Canadian marketplaces charge a wide range of ongoing and one-time fees for participants to connect to their marketplaces. We believe that any comprehensive regulatory effort to address the captive consumer problem for marketplaces cannot afford to overlook the risk that marketplaces look to such fees as a way to make up revenues lost in other areas. Here we would encourage the CSA to look to establish maximum baseline pricing for any such services designed to recoup the cost of such services rather than allowing these areas to become new profit centres.

Closing thoughts

Overall, we are very encouraged to see the CSA engaged in addressing the unintended consequences of OPR and seeking out a regulatory framework more supportive of productive competition. As we have outlined, both the proposed mechanisms associated to a threshold framework for protection and a protected/unprotected framework needs to be approached carefully. Failure to properly align all related regulations and ensure a sufficiently robust mechanism could fail to sufficiently support productive competition or worse, create new unintended consequences or counterproductive behaviours. This being said, there are still ripe opportunities to move forward on other important initiatives.

Pricing for market data and other ancillary fees, a uniform marketplace liability mechanism and tighter controls over marketplace technology changes – all these initiatives hold the potential for improvements to ensure that marketplaces act in ways better aligned with the public interests.

Again, we continue to believe that the practice of the payment of rebates should be curbed and ultimately eliminated. We believe this practice is at the root of not only the profound problems we see in the marketplace with conflicted order routing practices – but also damaging competitive behaviour on the part of intermediaries.

The difficulty for the CSA to explore meaningful change in Canada's interlisted securities is unfortunate and, we believe, emblematic of the importance of this issue. As such, we believe the CSA should continue to petition the SEC to ensure that Canadian interlisted names are included in any such pilot in the United States. Meanwhile, the CSA should proceed with a pilot study on non-interlisted securities as soon as possible.

Finally, as we have outlined herein, no pilot study or permanent market structure change can be evaluated as long as the CSA lacks a robust toolset to measure market quality. In fact, we believe that the near sole focus on narrowing of spreads was a significant driver in getting us where we are today. To address this issue we believe that the CSA should seek input from different constituencies to ensure analysis of more comprehensive, meaningful and relevant metrics going forward.

Please do not hesitate to contact the undersigned should you wish to discuss these comments further.

Regards,

Stephen A. Bain
Managing Director – Global Equities
RBC Capital Markets