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August 17, 2015

The Secretary
Ontario Securities Commission
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and

Me Anne-Marie Beaudoin
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Re: CSA Notice and Request for Comment
Proposed Amendments to the Companion Policy to National Instrument 23-101
Trading Rules: Application of the Order Protection Rule to Marketplaces
Imposing Systematic Order Processing Delays

Dear Mesdames and Sirs,

We write today on behalf of the institutional equity division of RBC Dominion Securities Inc. ("RBCDS") in response to the above noted request for comment. RBCDS welcomes the opportunity to provide comment on these proposed rule changes.

Today we find ourselves at an important crossroad for Canadian equity markets. In mere weeks participants face the launch of Alpha – a marketplace that, by functional design and explicit admission of its operator, aims to predominantly segment small-sized active retail flow from Canada's equity markets. In so doing, Alpha will introduce de facto investor segmentation to our lit markets for the first time and surely pave the way for propagation of more explicit and complex forms in the future.

It is our view that Alpha was approved through a short-circuited and therefore inappropriate regulatory process where neither the final model itself nor the regulatory framework accommodating it was subject to a proper public comment process. There are, in our view, two serious problems associated with this:

- *It undermines the integrity of and confidence in the comment process* – Allowing the approval of a marketplace proposal necessitating rules changes before those changes themselves have been subject to debate and comment undermines the integrity, legitimacy and therefore confidence in the comment process. To our knowledge this is an unprecedented decision – the implications of which the CSA should seriously consider.

- *Failure to seek a full understanding as to the long-term ramifications of rule changes and precedent established by the approved model* – If approved, we believe the combination of the proposed rule changes and the precedent established by the approved model will lead to implications and consequences that have not been sufficiently explored, considered or addressed. Again, this flies in the face of the entire rationale for a public comment process.

## Immediate concerns with the proposed rules

### False Equivalence

By painting all marketplaces which employ a "speed bump" as equivalent (whether used to curb predatory trading practices or applied broadly to allow de facto segmentation via latency arbitrage) approval of the proposal at hand opens the door to a world with far more complexity, uncertainty and confusion. More troublingly, it will pave the road for a new class of marketplaces where nearly anything goes (at least certainly as it relates to investor segmentation).

*The CSA should reflect*: How can a speed bump exist on Aequitas Neo today with no need for regulatory rule changes yet the Alpha model require modification of the National Instruments to: (a) create a new class of marketplace; (b) disaggregate the NBBO; and (c) lend regulatory sanction to latency arbitrage as appropriate? Is the above not clear evidence that "speed bumps" are not generic?

The reality is that the proposal at hand opens entirely new doors and drastically widens the scope of potential unintended consequence. Further, it subjects nascent competing marketplaces to rule changes required only to accommodate the competitive needs of the incumbent marketplace operator which raises serious competition, complexity, market quality and fair treatment considerations.

### Timing for Implementation

With the comment process closing a mere month prior to the launch of Alpha, it's unclear how the CSA can possibly give any real due consideration to feedback from the comment process. This creates the likelihood that Alpha launches without the changes required to accommodate its profoundly different business model. We are frankly at a loss as to how this is possible.

### Policies, Procedures and Best-Execution Guidance

The proposed rules leave many unanswered questions around how unprotected markets in a partial OPR world fit from a best-ex perspective:

a) Will it be appropriate to consume any liquidity on Alpha, a marketplace that intends to pay incentives for such activity notwithstanding the new risk in degradation in the ultimate quality of fills on a client order? Does this not amplify the problem of agency conflict? Will clients of retail networks have the information required to make reasonable judgment as to the quality of the fills they are receiving? Given the economic conflict introduced we believe the above raises specific best-execution concerns to which no clear guidance has been given.

b) Will it be appropriate to rest a client order on an unprotected marketplace? If so, which ones and on what basis? The reality is the creation of an unprotected lit market (particularly one that charges to rest orders) creates significant disincentives (both economic and regulatory) to the routing of resting orders to such a marketplace. Does this not amplify the risk for increased extraction of segmented retail flow to primarily proprietary intermediaries?

c) Specifically, approval of these rules taken within the context of the Alpha approval the OSC has offered guidance to deal with what is a national requirement as it relates to their interpretation of reasonable policies and procedures. Where this leaves participants outside the jurisdiction of The Province of Ontario is entirely unclear.

**How does the CSA propose to define 'intentional' order processing delays?**

From the proposal we are led to believe that intent will be solely established based on an intentional systematic order processing delay, irrespective of how small or whether it applies to some or all. This opens a variety of potential discussions as to what role geographic location or technology implementation might play in future discussions.

Beginning with the geographic, what if a marketplace proposed to launch in another Canadian province? At an extreme, a marketplace located in Vancouver for example would induce a one-way latency from Toronto to that marketplace through traditional fiber optic lines of, at minimum, just under 15 milliseconds – likely closer to 20 with most telcom line providers. Even a marketplace located in Montreal would introduce a minimum of 2.2 milliseconds – and likely above 3 for most telcom lines. Would the decision to locate a marketplace in either of these locations constitute an "intentional" order processing delay? Not to our understanding.

Likewise, what about the choice of a marketplace to maintain their exchange on old outmoded technology? Typically we would expect this decision to result in higher average latencies and less determinism (higher variability) in that latency. This could be argued to be cost savings tactic which could be argued part of a competitive model founded on low cost. Under the proposed rules this marketplace too would remain protected.

Finally, what about internal nuances of how marketplaces deal with different types of orders? Systematic nuances between posted orders, CFOs, cancellations and liquidity consuming orders can arise due to different processing times for such orders. This can always be defended as a result of the architectural decisions in how a marketplace is designed. Again – protected.

Clearly, a rule-set founded on intent is problematic. It is our view that regulators need to pursue a detailed understanding of the anticipated consequences of any new business model – in particular how it will impact investors and issuers. This should be the standard for protection. Whether marketplaces which don't meet this standard merit the creation of an unprotected lit market classification is an entirely separate discussion.

**Transparency and Complexity Challenges**

The existence of protected and unprotected displayed markets will give rise to locked and crossed quotes between unprotected and protected marketplaces. This is likely to create more confusion amongst investors and participants as to what the fair bid and offer is for a security and to whom what liquidity is accessible. Likewise, it remains unclear what will be a fair means to establish reference pricing for dark trades.

All of the above leaves a significant number of unaddressed oversights both within UMIR and the National Instruments. We believe this will have a certain and materially negative impact on marketplace transparency and fairness – with the potential for market quality and efficiency to suffer as well.

We are forced to acknowledge an evolution in our own thoughts on the merits of partial OPR since our comments from September of last year. Thereafter and within the context of the fallout from that comment process we found our views evolving on the merits of partial OPR. The challenge of course is that the OPR regime is well understood and has become an integral part of Canadian industry practices.

What became clear to us through the above process and that surrounding the comment process on Alpha is there are significant costs and complexities associated with a partial OPR regime – and that these factors are likely to make any such regime unrecognizable in relation to today's rule set. A clear testament to this is the fact that the CSA has, to date, yet to come back with a comprehensive approach to this file. With this in mind it seems unconscionable that we as a market are contemplating taking this serious step to accommodate a market that is introducing retail investor segmentation and payment for order flow to Canada's lit markets.

## Immediate concern with the approved Alpha model

### Cream skimming in a market that can't support it

Again, we believe this model institutionalizes implicit segmentation of retail sized flow and therefore de facto segmentation of natural investors into retail (specifically small sized retail orders) and the larger orders of institutional and some retail traders – entirely contrary to the long held principle that such segmentation could be disastrous for market quality and perceptions of fairness in Canada.

To our knowledge the introduction of such a model is unprecedented in the world of equity trading and particularly dangerous given the relative lack of depth and breadth in Canadian equity markets. Will this orphan or significantly undermine the NBBO that is equally accessible to all Canadian investors? Will this damage price discovery? Is Canada broad enough or deep enough to support this type of segmentation? Once Alpha is launched we will surely find out, but by that point it will be too late.

### Latency Arbitrage

It's important to give due consideration to this aspect of the model being accommodated through these rule changes. Broad investor and public concern specific to latency arbitrage has manifest itself since early 2014. It is understandable that the regulatory community is struggling with ways to cope with this problem. However, to sanction and institutionalize this treatment of long-term investors as acceptable business practice is quite another.

Specifically, the introduction of artificial non-deterministic latency to the detriment of investors and in service of short-term intermediaries is entirely contrary to the notion that markets exist to service said investors. This is quite simply the wrong approach and will undoubtedly breed significant fragmentation and complexity posing as innovation.

### Alpha can't simply be ignored

We strongly reject Alpha's claims that its new model can be ignored and traded around as altogether disingenuous and inaccurate. There are many reasons to expect otherwise, again:

- it introduces and amplifies existing agency conflicts;

- it creates a fragmented NBBO with all the attendant confusion and lack of transparency that entails;
- it will effectively segment predominantly small-sized retail active flow from other liquidity demanding flow; and
- it is likely to drastically shift the order flow of retail investors and intermediaries, with uncertain and quite possibly negative impact to market quality.

Such a nonsensical and clearly self-serving response should not be accepted at face value. It is our hope that the CSA takes the opportunity afforded by this comment process to reconsider the true implications of the path on which we are about to embark.

## Long-term outcomes

**Propagation of displayed, unprotected speed-bump markets**

We are confident Canada's other marketplace operators will be watching the launch of Alpha closely. Should Alpha achieve success in attracting retail order routing to its book we have no doubt that these other operators will soon move to replicate it. Equally, we expect each of these will come with their own flavor of precisely how they achieve segmentation. The result: propagation of fragmentation, complexity and investor confusion as to how our markets function.

**More phantom liquidity where it's not needed, less where it is**

With this new class of Alpha-style latency-arb inducing markets allowing the posting of conditional liquidity on multiple displayed markets it is reasonable to expect that this class of liquidity will grow – at least as it relates to proportional liquidity displayed. Of course, with all such marketplaces being all or nothing markets due to the regulatory sanction of latency-arbitrage, the damage will be done.

**Erosion of Canadian NBBO equally accessible to all investors**

As proprietary trades move to venues that serve up predominantly small-sized retail flow it is reasonable to expect the Canadian NBBO to widen and weaken – perhaps substantially. With full-book price protection still the rule on these markets and the degree of toxicity substantially increased we can expect this quote and therefore microstructure volatility to become increasingly erratic.

## In Closing

If these proposals are approved without further and proper consultation the die is cast – and we will move blindfolded into perhaps the worst of all possible worlds. Given this, it is increasingly easy to sympathize with the view that OPR has outlived its usefulness. Previously we've tried to hold to the hope that OPR could find a compromise – this is looking an increasingly faint possibility. Rather, once we take this step, it seems likely that the OPR regime will fade into irrelevance.

Let's be clear – allowing investor segmentation through latency-arb inducing speed bumps is unprecedented on the world stage and will (in our view) damage the reputation of Canada's equity markets. This problem will not in any way be ameliorated by casting these markets as unprotected – as discussed herein, this will actually compound the problem.

By contrast, the concept of utilizing speed curbs on professional speed-oriented intermediaries has precedent – an example being in foreign exchange markets. Not only does it have precedent, it also makes sense and today co-exists in Aequitas Neo with Canada's existing regulatory regime. Alpha and the proposed rules will change all of this.

The Alpha model was pitched by the TMX as a solution to deal with the threat of sale of retail order flow in Canadian listed names south. Consider seriously the costs for the CSA to accept this model and what we will give up in the process. There are other levers for Canada's regulators to employ that will not come with these costs.

As we indicated at the outset, we believe we have arrived at today's crossroads through an inappropriate regulatory process. We implore the CSA to take this opportunity to reconsider the costs and risks of the path on which it is about to embark.

Please do not hesitate to contact the undersigned should you have any questions.

Regards,

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RBC Capital Markets