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To whom it may concern:

Re: CSA Notice and Request for Comment - Proposed Amendments to National Instrument 23-101 Trading Rules

and

Re: IIROC Notice 14-0124 Proposed Provisions Respecting the Order Protection Rule

The Canadian Security Traders Association, Inc. (CSTA), is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling and trading of securities (mainly equities). The CSTA represents over 850 members nationwide, and is led by Governors from each of three distinct regions

(Toronto, Montreal and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world.

This letter was prepared by the CSTA Trading Issues Committee (the “Committee” or "we"), a group of 21 appointed members from amongst the CSTA. This committee has an approximately equal proportion of buy-side and sell-side representatives with various areas of market structure expertise, in addition to 1 independent member. It is important to note that there was no survey sent to our members to determine popular opinion; the Committee was assigned the responsibility of presenting the opinion of the CSTA as a whole. The opinions and statements provided below do not reflect the opinions of all CSTA members or the opinion of all members of the Trading Issues Committee.

The CSTA Trading Issues Committee appreciates the opportunity to comment on the proposed provisions respecting the Order Protection Rule (OPR) and the related proposed changes respecting the marketplace trading and data fees (the "Proposed Changes"). We agree with the CSA that the primary objectives of OPR, the promotion of confidence in the fairness and integrity of Canada's capital markets, are of paramount importance. As the shape and structure of the market progresses, Canada's regulatory framework must also evolve. We commend the CSA for engaging in a holistic review of the issues facing the markets today, including the unintended consequences of the well-intentioned implementation of OPR and its predecessor obligations.

The primary driver underlying any discussion of OPR and its consequences is the competitive nature of Canada's capital markets. There are two forms of competition to consider: the competition of individual orders on each trading venue (expressed as various priority models both implemented and proposed), and the competition of marketplaces for order flow from participants. The former aspect of competition has existed since the days of the Buttonwood Tree. The latter is a more modern development, recently accelerated and enabled by technology, and is the underlying subject of this response.

When considering the topic of OPR, we believe that the core question that must be asked is what type of competition we wish to have between markets and what the end purpose is for this competition. We believe that the landscape today is one of price competition (varying the fee structure of each market) and speed, although trading features are nearly identical across markets. Moreover, price competition among marketplaces translates in practice to competition in the level of marketplace rebate – a subsidy for posted quotations. We do not believe that price or rebate competition in itself is enough to drive innovation. On the other hand, we are collectively supportive of a regime where marketplaces are given an opportunity to offer a variety of investor-friendly features, and compete on the basis of the merits of those features.

We are of the view that to encourage competition between markets based on features offered, the regulatory subsidy being offered today – through the requirement of dealer members to maintain access (directly or via jitney) – must be minimized. Marketplaces should compete solely on the basis of their value proposition.

With respect to order protection, we see three fundamental alternatives being considered:

- A complete order protection regime, as is in effect today (the "OPR Regime").
- A partial, "threshold" order protection regime, as proposed in the amendments (the "Partial-OPR Regime").
- A repeal of OPR and focus on accomplishing the goals of investor protection using robust "best execution" guidelines for dealers the ("Non-OPR Regime").

We note that regardless of whether OPR is maintained as-is or is relaxed to a "threshold" model, the majority of orders in the market today will retain order protection. By implication, dealer members will continue to be in an inferior position of negotiation to the marketplaces due to the requirement to connect and access all protected markets under OPR. As a result, regardless of whether a threshold model is adopted or not, the near-monopoly powers of protected marketplaces must be checked to manage the captive consumer problem at the heart of the current OPR debate. We discuss specific concerning aspects of the captive consumer problem below.

Best Execution in a Non-OPR or Partial-OPR World

We are supportive of a requirement for dealers to provide plain and fulsome disclosure of their best execution practices to clients, and compete on the basis of providing appropriate services to their clients. However, we are concerned that a Non-OPR, or Partial-OPR model for the market will give rise to prescriptive best execution guidance from either the CSA or IIROC, which will de-facto drive dealers to a similar outcome to today. For example, if best execution guidance prescribes a specific and strict test for when a marketplace's quotes should be accessed for "best execution" regardless of OPR requirements, dealers will find themselves compelled to connect. This would result in marketplaces otherwise unprotected by OPR enjoying the same benefits they enjoy today – an unintended regulatory subsidy. Further, a regime of relaxed OPR with overly prescriptive execution guidance would fail to recognize the difference in various dealers' business models and value propositions to their clients, and fail to give dealers the opportunity to compete for client business on the basis of a difference in service.

Coincidentally with the proposal at question, we are concerned with the reiteration of the IIROC guidance relating to client priority under UMIR 5.3. The guidance would preclude a dealer from resting client orders on an unprotected marketplace if there is any possibility that an unrelated non-client order from the same dealer rests on a protected marketplace. At the heart of this guidance is a judgment call that protected marketplaces are more likely to receive a fill than unprotected ones, and for the purpose of a client's execution, that the protected marketplaces are superior. We respectfully disagree and point to the success of certain marketplaces – such as CX2 Canada ATS – at achieving meaningful penetration despite a market share level that would preclude protection. We are concerned that any prescriptive guidance of this nature would de-facto ensure that dealers never rest client orders on unprotected marketplaces, regardless of the value proposition of their features, for fear of violating best execution or client priority rules. Worse, dealers may be compelled to hold orders off the visible book rather than post on an unprotected market for fear of a UMIR 5.3 violation (where permissible under best execution policy and the order exposure rule). This would create a tremendous barrier to entry to new marketplaces and ensure that any traction new marketplaces gain must be entirely on the basis of proprietary or HFT (directed) order flow instead of agency business from traditional dealers. We believe this is contrary to the goal of sustainable healthy competition among marketplaces.

We respectfully suggest that UMIR requirements relating to client priority focus on a policies & procedures requirement to ensure that client execution takes place fairly in the context of non-client activity, rather than introducing a "hard & fast" requirement with major deleterious side effects.

Technical Issues with Unprotected Markets

A major positive consequence of a universal OPR regime is clarity around what constitutes the "inside market" or the "Canadian Best Bid and Offer" (CBBO). In any regime other than complete protection of all orders, one must open the possibility that some order may not be accessible by all participants and thus not part of the CBBO calculation. This has implications for marketplace pegged orders, dark pool mid-point matches, and market data dissemination.

If the CBBO consists of only protected quotations, then dark pools may be required to print trades at prices that are outside of the quotes being shown by marketplaces which are unprotected but are still generally accessed by the majority of the Street (such as any markets deemed unprotected when the Proposed Changes are implemented). This outcome is at odds with the spirit of Canada's dark regime, as it is hard to see how a dark order offers "price improvement" by printing trades at worse prices than quotes which are generally accessible by many dealers despite being unprotected.

On the other hand, if the CBBO includes unprotected quotes, dark markets may be unable to print trades in a situation of a locked or crossed market. In this situation marketplaces reliant on a CBBO will be at a disadvantage through no fault of their own. In an extreme case, a marketplace operator could open a book with onerous access requirements and show quotes (perhaps resulting from orders by a related party) for the express purpose of interfering with a competing dark market's operations.

In all cases, we believe some controls are required to prohibit participants who are generally able to access a certain unprotected market from locking that market. We believe that intentionally locking an unprotected market despite being able to access those quotations is contrary to the spirit of just and equitable trading. A similar prohibition should apply to Access Persons using multiple dealers to lock a quotation by entering orders on both sides of the lock based on the knowledge of which dealers are unable to access certain unprotected markets.

Finally, we note that in all events, TMX Group Ltd. is responsible for the role of Information Processor (IP) and is responsible for publishing the CBBO data feed. We believe that this feed is regularly used as a reference for Canadian data. By excluding certain marketplaces from the CBBO through definition, the proposed regulation would de-facto introduce a hurdle to the dissemination of quotes from those markets. This represents a significant barrier to entry for new marketplaces. We also do not believe that TMX Group Ltd., as a commercial for-profit enterprise, would be incented to voluntarily publish an unprotected quotation alongside the protected CBBO – when that unprotected quotation would enable its competitors to attract order flow. Therefore, any re-definition of the CBBO to the exclusion of unprotected markets should be accompanied by a requirement for the IP to expand its dissemination of quotations to include unprotected markets.

We note that similar "inaccessible" or "unprotected" quotations exist in other asset classes, such as foreign exchange. In the case of the foreign exchange markets, to the extent that trading is bilateral and based on credit relationships between counterparties, only some quotations may be accessible. However, we note that FX trading platforms generally disseminate both the overall best quotation in the market and the quotations offered by suitable counterparties. A similar model may need to be introduced to Canadian equity trading – which, in turn, may raise reliance on the IP and an increase in the IP's monopoly power.

The Captive Consumer Problem

Whether the chosen regime is complete order protection or a Partial OPR model, we are concerned that some marketplaces will continue to enjoy monopoly-like power over their subscribers. We note that the Proposal attempts to address the market data aspect of this challenge, and we commend the CSA for taking the difficult step of directly regulating the price of market data services. However, there are other aspects to the Captive Consumer Problem which remain unaddressed, and are equally important.

Market Data Life Support

We commend the CSA for directly tackling the issue of escalating market data fees, particularly those being charged to professionals. Canada's data fee regime currently represents a burden on the Street. However, notwithstanding the hard costs charged to participants, our primary concern is the impact on commercial incentives from offering a for-profit marketplace the ability to charge its users for data they require as part of their regulatory obligations. This regime is a means for marketplaces which are otherwise commercially unviable to remain in operation, and we refer to this as "market data life support."

We see two fundamental problems:

1. The absolute level of market data fees charged by marketplaces
2. The impact on incentives – particularly for new entrants – from the ability to charge market data to a captive audience.

We broadly agree with the CSA's stance on establishing global reference levels for market data fees, and requiring all marketplaces to adjust their fees to more reasonable levels. We suggest that the benchmarking methodology extend in time to a period prior to the current multiple-market regime, i.e. prior to 2007. Additionally, the model should take into account the cost of production and delivery of market data, in particular the infrastructure costs already borne by the Street for consuming market data. An equitable framework would focus on managing the users' cost of receiving market data, including both marketplace data fees and infrastructure costs. We are concerned that the proposed model only addresses half of the equation.

We also ask that the CSA mandate that marketplaces institute a mechanism by which users subscribing to market data across multiple devices simultaneously be allowed to net the costs and avoid paying for the same data twice. A multiple-instance, single-user ("MISU") regime exists south of the border and presents significant cost relief to users. It is also the most equitable means of dealing with users who may require multiple applications consuming the same data, or multiple terminals consuming the same data for the same user.

Finally, we believe that the degree to which the proposed market data regime will be effective depends in part on whether OPR is ultimately relaxed to a threshold model. In an environment where any new marketplace can demand that users connect and pay a fee, a moral hazard is introduced. We believe that in a Partial OPR regime market forces will prevent marketplaces from attempting to charge unreasonable fees for market data. However, in a full OPR regime, care must be taken that new entrants cannot use market data as a subsidy for starting operations. New entrants must begin operations with sufficient financial resources to be a going concern, and without relying on the ability to charge a captive client base at inception.

Connectivity Fees

Marketplaces currently charge baseline connectivity fees, administrative fees and other ancillary fees for all dealers connecting. We believe that these fees represent an undue burden on smaller dealers, and are another form of regulatory subsidy for upstart marketplaces. We are concerned that in a regime where marketplace data fees and trading fees are curbed, marketplaces enjoying OPR benefits will be compelled to increase "other" fees to compensate for lost revenue from market data.

Technology Changes

A major aspect of the captive consumer problem that remains largely unaddressed is the ability of marketplaces enjoying OPR protection to impose technology costs on connecting dealers. For example, the TMX Group recently engaged in its "Quantum XA" initiative across multiple order books at a considerable cost to the dealer community. These costs include the time, effort and budget required to implement the changes, and also the opportunity cost of technology staff being committed to the Quantum XA integration at the expense of other projects relevant to the dealer.

While we do not wish to single out Quantum XA as the only example of marketplace technology initiatives with externalities to the dealer community, it is the most significant in recent memory. We continue to be concerned that the project may represent an unacceptable cost-benefit trade-off to most participants, and is geared towards a subset of users while imposing costs on all. We believe that greater governance is needed when dealing with projects carrying significant externalities.

This example serves to highlight the monopoly-like power of protected marketplaces to impose their technology initiatives on dealers.

Currently, technology efforts which do not result in a change to marketplace function are not subject to a public comment process. We kindly request that, in addition to the Proposal under discussion now, National Instrument 21-101 ("Marketplace Operations") be amended to include a requirement for a public comment process on any technology effort requiring material effort on the part of dealers and vendors. In this case, we are comfortable with allowing the lead regulator for each marketplace to determine whether a marketplace's technology proposal "material".

We believe the introduction of public scrutiny should closer align the incentives of protected marketplaces to the needs of the Street. A requirement for public consultation by a protected marketplace should give rise to a more comprehensive cost-benefit analysis by each marketplace proposing technology changes, because of the possibility that technology initiatives are stalled or rejected outright on the basis of feedback from the Street. This will ultimately lead to an environment where the trading infrastructure for Canada's capital markets is more balanced to the needs of all participants.

We recognize that marketplaces will object to this proposal on the basis that technology efforts are a competitive matter. We believe that by requiring dealers to connect to a marketplace's trading infrastructure, any intellectual property included in a public filing will be in the public domain in short order regardless. Competing marketplaces (for example those operating smart routers for OPR compliance) will be privy to the technology at question, and will imitate good ideas as they see fit. Additionally, we believe that if a positive innovation at one marketplace is copied by another, the Street benefits through wider adoption of good ideas.

Marketplace Liability

The issue of comprehensive indemnity clauses in marketplace subscriber agreements remains topical in any environment where dealers are required to connect to a marketplace. We acknowledge that the negotiating power of dealers is greatly strengthened when accessing an unprotected marketplace. However, the Partial-OPR approach does nothing for dealer negotiating power with large incumbent markets – the very same markets where losses from technological outages are likely to be highest.

The possibility of marketplace outages leading to dealer loss is not a hypothetical concern. South of the border, the well-publicized marketplace outages related to the BATS IPO and the Facebook IPO resulted in compensatory payments. In Canada, the August 14^{th}, 2014 failure of the TSX Market-on-Close facility was a reminder of the reliance the Street has on the facilities of certain marketplaces. Had this particular outage taken place on the day of a major index rebalance or another end-of-day event, dealers and investors may have been subject to significant losses and uncompensated market risk. Currently there is no framework for managing this outcome.

We believe that the lack of indemnity today creates a moral hazard at marketplaces, which can operate with the knowledge that a catastrophic outage resulting from negligence in operations or software development will essentially be cost-free to that marketplace. This creates an environment where the incentive to maintain reliable systems is based on reputational concerns alone, instead of the possibility of a major direct financial impact. This incentive is not strong enough. Marketplace technology and operations are simply too critical to Canadian capital markets, and to our markets' global reputation, to be managed solely by the reputational concerns of individual for-profit entities.

We respectfully ask that, separately from the proposed provisions to NI 23-101, the CSA introduce amendments to National Instrument 21-101 ("Marketplace Operations") requiring marketplaces to maintain reasonable policies and procedures to compensate participants in situations where a marketplace outage directly results in losses to the Street. An appropriate liability regime would include a framework for claim resolution, subject to caps, which would ensure that any payment of compensation for losses is punitive to the negligent party without being unaffordable for smaller marketplaces.

Fragmentation and the Make-Take Pricing Structure

Some contributors to this submission expressed a sentiment that we collectively overpay for the liquidity we receive through marketplace rebates, while other believe that we need to evaluate rebates in the context of a given securities liquidity and spread profile to be able to ascertain whether a rebate is contextually appropriate. We note that for some order flow executed in Canada for which participants will generally pay take fees, US wholesalers routinely pay to receive this order flow. This suggests that, notwithstanding discussions of order flow segmentation built in to payment for order flow, we may be fundamentally paying too much for the liquidity we receive.

We acknowledge and commend the CSA for attempting to address the cost of trading for dealers. A reduction of the maximum fee to $0.0030 per share for equities at or above $1, and $0.0004 per share for equities below $1, is generally seen as positive. However, in practice, some do not believe the cap will do enough to manage the overall economics of trade – and will not address the conflicts built in to make/take pricing.

The basic problem of disparity between the US and Canada in the level of marketplace rebates is concentrated primarily in interlisted securities, which happen to be some of the largest and most liquid stocks in Canada. Care must be taken to ensure that any fundamental change to marketplace pricing does not create undue incentives for Canadian order flow to migrate south, for example on the basis of tighter bid-ask spreads which mask higher overall execution costs – which are borne by the dealer intermediaries and cloud best execution.

Some contributors are generally supportive of the CSA's proposal to pilot a ban on marketplace rebate. However, given the tight links between Canadian and US capital markets, we must be cautious to the implementation of the pilot. Specifically:

- Unless the pilot is coordinate with US authorities, the inclusion of interlisted securities may severely undermine their trading in Canada and drive order flow south of the border. Simply put, if the effective quoted level in the US is generally better due to the presence of a rebate, and the corresponding higher trading fee is borne by dealers, it will be difficult for dealers to justify keeping order flow in Canada on the basis of best execution. This problem extends to payment-for-order flow arrangement in the US, and would encourage a cross-border pilot which combined a ban on marketplace rebates with a ban on payment for order flow in both jurisdictions.
- Any pilot study must be sufficiently wide in scope, and long-lasting, to trigger a change in behavior among Canadian participants. We recommend a minimum time frame for the pilot of 12 months, and cover a broad range of securities.
- The pilot must include definitive and impartial success criteria. Some consequences of the pilot may be easily foreseeable – for example, a widening of the spread. However, the extent of the impact may not be obvious – for example, spreads may widen by less than the reduction in marketplace rebates, reflecting the degree to which some view we overpay for visible quotes

We strongly encourage the coordination of the make/take pilot with US authorities to permit the inclusion of at least some interlisted securities. Without coordination with the regime in the

US for equivalent stocks, we fear that the inclusion of interlisted stocks may lead to an economic disparity between the markets which can lead to net harm. It is not enough to simply "stop the pilot" on evidence of damage, as the perception of "better" trading south of the border may extend outside of the timeframe of the pilot, and be difficult to correct.

Ultimately we believe that the success or failure of the pilot, and the adoption of the results on a go-forward basis, will embed a judgment of whether the elimination of make/take driven conflicts of interest and fragmentation incentive is worth any potential cost to investors. While it may be difficult to directly ascertain the costs to investors, we believe that a pilot study on make/take would be incomplete without impartial success criteria.

To the extent that make/take friction is typically absorbed by dealers, investors may benefit in part through greater visible liquidity. It follows that an elimination of rebates may be a benefit to dealers more than to investors. If the main benefit to investors from make/take is an increase in quoted volume from a liquidity subsidy, analysis of the effect of rebates must take into account any drop in quoted volume on the basis of a reduction in rebates, even if the overall bid-ask spread does not change. This reduction in posted volume represents an opportunity loss for investors who may be liquidity seeking, and should be quantified.

Such analysis should be tempered with the ancillary benefits of improved tape transparency (through the elimination of rebate-driven sub-penny price improvement contrary to UMIR), a reduction in deemed unnecessary intermediation, the potential for consolidation of order books, and reduced conflicts of interest. These latter benefits cannot be quantified purely through observed average bid-ask spreads.

Conclusions

We commend the CSA for undertaking the comprehensive and very complex task of reviewing the implications of the Order Protection Rule on the market today. At the core is the question of the role of commercial competition in the marketplace business. We believe that marketplaces serve a central role in capital markets, and should be free to compete on the merits of their value proposition. We are supportive of all the efforts to reduce the degree to which competitive entrants are given a regulatory subsidy for their operations, as we believe such regulatory support introduces moral hazard into the heart of Canada's capital markets.

We believe that each of the potential resulting OPR regimes carries with it a trade-off.

- A best-execution driven regime must be carefully tailored to avoid overly prescriptive best execution guidance, as a best execution prescription may prove equivalent to OPR today – without the benefit of extending OPR to those parties not subject to best execution.
- A Partial-OPR regime carries challenges of reconciling the dynamic between protected and unprotected markets.
- Any regime including order protection must specifically target a range of monopoly powers exerted by protected marketplaces, which are not limited to the market data reform contemplated in the Proposal.

In aggregate, we are comfortable with an order protection regime (either partial or complete) provided that the commercial powers of protected markets are severely curtailed in the areas discussed above. We believe that a regime where competing marketplaces are granted order protection without the benefits of regulatory subsidy will encourage competition on the basis of marketplace features and lead to an innovative, dynamic market environment for equity trading.

We appreciate the opportunity to comment on this matter.

Respectfully,

"Signed by the CSTA Trading Issues Committee"

c.c. to:

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Ms. Susan Greenglass, Director, Market Regulation
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