13.2.3 Aequitas NEO Exchange Inc. – Notice of Proposed Change and Request for Comments

AEQUITAS NEO EXCHANGE INC.

NOTICE OF PROPOSED CHANGE AND REQUEST FOR COMMENT

We are publishing this Notice of Proposed Change and Request for Comment (Notice) in conjunction with a request for comment on a fee proposal filed by Aequitas NEO Exchange Inc. (Aequitas)(Fee Proposal).

Staff request for specific comment

Aequitas is proposing a fee change to the NEO Book. Currently, the NEO Book has an inverted trading fee model where active marketplace participants (active participants) receive a rebate and passive marketplace participants (passive participants) pay a fee to post liquidity. Aequitas is proposing a change to this fee model where an active order from a NEO Trader[1] would receive a rebate, while an active order from a Latency Sensitive Trader (LST)[2] would not receive a rebate. At the same time, the passive side of the trade would pay less to post when it executes against an active LST.

In considering Aequitas's Fee Proposal, Staff is seeking comment on the whole proposal and on the following issues.

1) Fair access – Staff question whether the Fee Proposal would be unfair to passive participants because their fees are determined by the nature of an incoming order and not by their own actions or decisions.

2) Leakage of information – Staff is concerned that the Fee Proposal would allow for passive participants in the NEO Book to have an informational advantage over other marketplace participants, as they would know, based on the fee they pay, whether they traded against orders from LST or NEO Traders. This information would not be available to any other marketplace participant. We note that Aequitas is proposing to address this issue by paying the fee credit due to lower trading fees to the applicable passive participants at the end of the month, and report it only on an aggregate basis. However, we are concerned that this may not fully address the information leakage concern. We also question whether it is reasonable for a marketplace participant to wait until the end of the month to calculate their true overall trading costs.

Submissions of comments

Comments on the Notice should be in writing and submitted by August 2, 2016. to:

Market Regulation Branch
Ontario Securities Commission
20 Queen St. West, 22nd Floor
Toronto, ON
M5H 3S8
marketregulation@osc.gov.on.ca

And to:

Cindy Petlock
General Counsel & Corporate Secretary
Aequitas NEO Exchange Inc.
155 University Avenue, Suite 400
Toronto, ON, M5H 3B7
Email: legal@aequin.com

Comments received will be made public on the OSC website. Upon completion of the review by OSC staff, and in the absence of any regulatory concerns, notice will be published to confirm the completion of Commission staff's review and to outline the intended implementation date of the changes.

[1] This is defined in Aequitas's Trading Policies as an account type or an investor that trades through an account type other than LST.
[2] This is defined in Aequitas's Trading Policies as either a proprietary trader of a marketplace participant, trading for its own account, using automated, co-located trading strategies, or as a direct electronic access client using automated, co-located trading strategies and making its own routing decisions.

TRADING NOTICE

DATE: JUNE 30, 2016 **NOTICE #: 2016-021**

Change to NEO Book™ Trading Fee Model – Request for Comments

Proposed NEO Book™ Differentiated Pricing

Aequitas NEO Exchange is seeking comment on a proposed NEO Book™ fee model change, whereby whether or not an active rebate is received would depend on the type of active order flow (the "**Proposed Fee Change**"). Under the proposal, an active order from a natural investor (NEO Trader™) would receive a rebate while an active order from a Latency Sensitive Trader ("**LST**"), as defined in the NEO Exchange Trading Rules, would not receive a rebate. At the same time, the passive side of the trade would accumulate a fee credit equal to the active rebate when it trades against an LST. Any such fee credit would be paid out at the end of the month and reported only on an aggregate basis in order to eliminate any information leakage.

Expected Date of Implementation of the Proposed Fee Change

Subject to any changes resulting from comments received and receiving regulatory approval, the Proposed Fee Changes will be effective September 1, 2016.

Rationale for the Proposed Fee Change

The NEO Book's inverted pricing model was made permanent as of June 1, 2016. We have continued to monitor the impact of this fee model and we have noted, not unexpectedly, that the active rebate attracts multiple types of active order flow, including that from HFTs. As the NEO Book was designed to protect and reward liquidity for investors, Aequitas NEO Exchange is seeking to remove the economic incentive for other types of flow to take liquidity. The solution we propose is to accumulate the rebate that is forgone on the active side and apply it to the benefit of the liquidity provider. This would give Designated Market Makers and other liquidity providers further reassurance that if they pay to post on the NEO Book they will interact more often with natural investors; and, if they do end up trading with LSTs, they will receive a credit against their posting fees. The net fee for the NEO Exchange would remain the same in all cases.

Expected Impact of Fee Change on Market Structure, Members, Investors, Issuers and Capital Markets

No impact is expected on market structure, but it would likely reduce the amount of active flow received from LSTs. The expected impact on members, investors, issuers and the capital markets is neutral to positive – as it should mean that the quality of liquidity improves.

Although the Proposed Fee Change would provide for the application of different trading fees for passive liquidity providers based on the nature of the incoming (active) order, the impact on liquidity providers would generally be positive and, at worst, neutral. The liquidity provider would be charged the currently approved passive fee, which is consistent with the passive fees charged by other marketplaces, when it trades against a non-LST. This is the status quo. However, the liquidity provider would receive a credit at the end of the month if some of their trades were with an LST. From the active perspective, non-LST orders would receive the same rebate as they do today and LSTs would be aware in advance that they will not receive a rebate, so that they may route accordingly. The Proposed Fee Change would benefit the liquidity provider because: (a) it would reduce the incentive for an LST to trade actively on the NEO Book, increasing the likelihood of trading with natural investors; and (b) if an LST determined that it was still interested in trading actively at the posted price, the liquidity provider it traded against would effectively pay a lower fee.

We do not expect any other impact, and that includes no expectation of information leakage. Since all types of active orders may continue to trade in the NEO Book, there is no way for any participant to know with certainty the type of order flow it is executing against. More specifically, there would be no information on the trade message regarding the counterparty's classification, or what fees will be applied. This would only be apparent on liquidity providers' invoices at the end of the month, on which they would receive a credit aggregating the amount set aside for all the trades where they had traded against an LST.

Impact on Exchange's Compliance with Ontario Securities Law and on Requirements for Fair Access and Maintenance of Fair and Orderly Markets

No expected impact on compliance with securities law. As noted above, we view the Proposed Fee Change as a balancing of costs and benefits for providing passive liquidity – the maximum fee, charged when trading against the preferred type of order flow, remains the same, but the fee is effectively reduced when interacting with other types of order flow.

Consultations

We have consulted with a cross-section of our members, including Designated Market Makers and several major retail dealers, as well as some electronic liquidity providers who were all neutral to positive about the changes. The consensus is that the Proposed Fee Change should reduce the number of rebate-based arbitrage opportunities for HFTs and increase the perceived value for liquidity providers who know they will pay to post when interacting with natural flow.

Does this Represent a New Fee Model that Currently Exists in Another Jurisdiction?

The differentiated pricing based on participant type was part of the original fee model for the NEO Book, but we feel this model is preferable as it should be effective without being seen to be penalizing anyone and because we would not be capturing a larger spread for ourselves, depending on the type of active flow.

Comments

Comments should be provided, in writing, no later than August 2, 2016 to:

Cindy Petlock
General Counsel & Corporate Secretary
Aequitas NEO Exchange Inc.
155 University Avenue, Suite 400
Toronto, ON M5H 3B7
e-mail: legal@aequin.com

with a copy to:

Market Regulation Branch
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8
e-mail: marketregulation@osc.gov.on.ca

Please note that, unless confidentiality is requested, all comments will be made publicly available.