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Market Regulation Branch
Ontario Securities Commission
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Via email to: marketregulation@osc.gov.on.ca

Randee Pavalow
Chief Compliance Officer & Legal
Aequitas Innovations Inc.
Via email to: randee.pavalow@aequin.com

Re: OSC Staff Notice and Request for Comment - Aequitas Innovations Inc.

Dear Mesdames and Sirs,

Liquidnet would like to thank both the OSC and Aequitas for the opportunity to comment on the proposed Hybrid and market making models.

Liquidnet is the global institutional trading network, connecting over 700 of the world's top asset managers to large-scale equity trading opportunities across the globe. Liquidnet complements what retail markets provide by defending and securing the integrity and the anonymity of the block trade – all while pursuing additional and differentiated sources of safe, actionable liquidity from asset management firms, exchanges, brokers and corporations. Asset Managers rely on Liquidnet to help them protect the performance of investor's portfolios, by allowing them to enter and exit their portfolio positions more efficiently.

Active in 42 markets across 5 continents, we welcome and drive healthy debate on market structure in Canada and globally, promoting innovation that improves markets for institutional investors, and ultimately for the millions of individuals our Members serve.

We have evaluated the proposals tabled, including considering where we previously have introduced similar innovations. We are pleased to contribute our experience and views to this debate.

The following are our responses to the questions, as posed in the Request for Comment.

Question 1: *Should OPR apply to all visible markets and to all orders displayed on those markets, or are there circumstances where the application of OPR should be limited?*

OPR should not be limited but rethought and redesigned to embrace changes in market structure. However under current regulation for a marketplace to be considered “protected”, quotes must be visible, accessible and immediately executable. If a marketplace meets the above criteria then OPR should be equally applied.

Question 2: *Should OPR apply to Hybrid? Should it continue to apply at least with respect to active non-SME orders that are not restricted from accessing the best-priced displayed orders on Hybrid?*

The Liquidnet community has long held that investors should have the right to choose the type of counterparties that interact with them. The Liquidnet model provides our community with that choice.

As proposed, Hybrid restricts access to SME orders taking liquidity and therefore quotes are not accessible to all market participants. Therefore, OPR should not apply to Hybrid quotes. The complexities surrounding achieving the objectives of OPR versus the introduction of the Hybrid model highlight the need for greater review.

Question 3: *If Hybrid is implemented as proposed, how should the best-priced displayed orders on Hybrid be treated for the purposes of consolidated display requirements, and why?*

Since Hybrid does not meet the current criteria for protected market status under OPR, it should be treated as an unprotected market. However if Liquidnet were to propose similar functionality, we would suggest that the aggregate quotes provided by Hybrid be displayed as broker 001 (unattributed) quotes.

Question 4: *What should the appropriate reference price be for determining whether a dark order on any other market has provided minimum price improvement as required under the Dark Rules – the Away NBBO or the NBBO that includes a Hybrid best bid and/or Hybrid best offer? Does the answer to this question depend on whether or not OPR applies to Hybrid?*

Since the Aequitas Hybrid model does not meet the requirements of IIROC’s protected marketplace definition, price improvement calculations should use the Away NBBO.

Question 5: *How should fair access requirements be applied with respect to access to visible marketplaces?*

Fair access requirements should be applied to visible markets equally. Our own experience has shown that standards and restrictions on access can be used to create safer markets for clients to interact in and that better align with their trading interests. Having said this, regulators need to ensure that proposed restrictions are reasonable and fit within the current rules framework.

Question 6: *Should visible markets be fully accessible or, like dark pools, should access restrictions be permitted? Why? What are the criteria that should be used to determine if the differences in access are reasonable? What impact, if any, could restricting access to the best displayed price have on confidence and market integrity?*

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To be clear, access restrictions are not only found in dark pools. Lit markets impose their own access restrictions, whether it be who is permitted to access the marketplace directly for trading (i.e. IIROC member, PO) or which order may be entered during a specific time period (i.e. MOC). Albeit different forms of access restrictions, they are, none the less, restrictions. Keep in mind that a broadly accessible market is the essence of OPR.

Contrast this with unprotected (currently, dark) markets that exist and persist based solely on the value they offer to their subscribers who choose to send their orders there. Lit markets, on the other hand, enjoy regulatory protection. If a dark market imposes restrictions on access that are reasonable, yet not acceptable to a subscriber, the subscriber is free to choose another marketplace to transact upon.

Question 7: *Are the access restrictions proposed for Hybrid consistent with the application of the fair access requirements?*

Investors, in particular asset managers, have a requirement to understand the nature of the liquidity they are interacting with and to determine whether that liquidity is "toxic" or not to their interests. Giving investors choice drives confidence in markets and ensures that investor goals are aligned are aligned with marketplaces offerings.

Question 8: *Is the SME marker an appropriate proxy to identify the behaviours Aequitas seeks to restrict?*

SME is a marker of convenience. It allows for identification of participants whose strategies are short term and as such, may not be aligned with the long term objectives of institutional investors. In Canada, Liquidnet has historically restricted its membership base to institutional investors, since inception and more recently, with the launch of our Broker Blocks product in October 2012, have added non-SME agency only orders from broker blocks participants.

Question 9: *What, if any, is the impact on market quality and market integrity if market makers are provided matching priority (after broker preferencing)?*

It depends on what the return on value is for affording the market makers this priority. Does the market receive the same benefit from a market maker when trading a liquid versus an illiquid security? If the value of a market maker on a liquid stock is minimal, as market forces already create a consistent and reasonable two-sided market, why should the market maker get any priority preference?

As a side comment on allocation priority, the Aequitas allocation model perpetuates broker preferencing (some may say internalization) that hinders the ability of customers of medium and small sized brokers from competing with the customers of larger players. In essence, it binds clients to the large brokers in order to queue-jump priority and ultimately results in a reduction in choice for customers as to which broker to use and a reduction in overall dealer competition. In 2013 we have seen a number of firms close shop we caution that greater consideration to the effects of broker preferencing is required.

Question 10: *In light of the details of Aequitas' proposed market maker program, is it reasonable to provide the benefit of priority to a market maker in the Dark and Hybrid books when the market maker's corresponding obligation is limited to the Lit book? If not, should there be market making obligations in Aequitas' Dark or Hybrid books?*

Again this depends on the net benefit provided by the market maker. Extending the priority privilege to the Dark and/or Hybrid books could assist market makers in building and decreasing positions as required to manage their lit book responsibilities. However, since there is no obligation for market makers to trade in the Dark or Hybrid books and therefore no return for the priority value that would be afforded to them, they should not be given any priority preference.

Question 11: *Should market making benefits accrue with respect to obligations for market making in non-Aequitas listed securities? If so, why and if not, why not?*

More detail is required around the Aequitas market maker proposal in order to make any firm statements about the proposal. We are told the rights of the market maker but are not provided with the obligations of the market maker in order for us to be able to determine the net benefit. We do wonder about the "orderly market" effectiveness of a market maker operating solely on a marketplace that has a small share of overall volume and whether the rights given to a constrained market maker would be warranted.

This is an interesting question because it highlights that the role of the market maker has been greatly impacted by the introduction of multiple markets. When there was only one market to trade TSX securities, a market maker's trading was linked to the listing market. The market maker was able to source and release shares in one place and effectively manage the risk associated with discharging its obligations.

With the introduction of multiple markets, the connection between the listing market and the benefits of having a market maker was weakened as trading now could occur away from the listing market. The market maker obligation remained with the listing market and the benefits of the market maker were not extended to other markets trading the same security.

Question 12: *Should DEA clients that are not subject to the direct regulatory authority of the securities regulatory authorities, IIROC and/or the exchange be permitted to act as market makers? Why or why not? How would the following facts affect your response: (i) the DEA client market maker must be sponsored by an IIROC member and (ii) the DEA client market maker must be a member of a self-regulatory organization such as FINRA or otherwise subject to appropriate regulatory oversight?*

Trust is fundamental to the Canadian market. A preferred role such as market maker impacts strongly on trust. Both issuers and participants are assured that IIROC member market makers are registered representatives that have met educational requirements and obligations set forth by our regulators. They are experienced in trading Canadian securities and the nuances of our markets. They are also directly under the oversight and jurisdiction of Canadian regulators. Even if the DEA market maker was sponsored by an IIROC member, we are concerned that if an issue arose with their market making activities, Canadian regulators may have difficulties in discovering the root of the issue(s).

In addition we caution that allowing foreign traders who are not bound by the same requirements of an IIROC member may not provide the same level of service. This does not mean that they would not provide volume and quotes, rather they may not necessarily respond to market conditions and events as would an IIROC member market maker.

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Question 13: *Will an un-level playing field be created between DEA client market makers and registered investment dealers that also seek to become market makers on Aequitas' proposed exchange? If so, what are the potential implications in terms of fairness or market integrity?*

Anytime you make exceptions or changes to rules or policies to accommodate one group over another you have the potential to tilt the playing field one way or another. Does allowing DEA market makers do this? Market makers from registered investment dealers must meet certain accreditation as well as continuing education requirements. These Canadian requirements are not required of a DEA client; rather they just need to acknowledge they are familiar with Canadian marketplace and regulator rules, policies and procedures. There is no formal test of this knowledge. This demonstrates an inequality in the certification and/or qualification requirements of the two types of market makers.

Question 14: *How might Hybrid impact the quality and integrity of the visible market as a whole?*

The Aequitas Hybrid market, if treated as a protected market, would complicate the current OPR application and would be detrimental to market quality and integrity. It would create a two-tiered quote where one is accessible by all participants and another by a subset of participants.

Question 15: *Please comment on whether the potential benefits of Hybrid for the marketplace participants in Hybrid outweigh any potential risks to the market as a whole? Please identify the relevant benefits and risks.*

We do not dispute the potential benefits of the Hybrid model. We do however express concern with applying OPR to Hybrid when it does not fit the current rules.

Question 16: *How should the principles of the current regulatory framework and any potential for changes to that framework impact the OSC's consideration of Hybrid? For example, should Hybrid go forward on a pilot basis and be reevaluated based upon some criteria or threshold? What type of criteria or threshold might be appropriate to minimize potential negative impact?*

The OSC should consider Hybrid in the context of the current rule set and not under any proposed rule(s). Hybrid as a protected market should not go forward as an "outside the rules" pilot. We applaud innovative approaches to addressing issues in our marketplace but we do not support a bending of the rules or provisioning of short cuts to create "quick fix" solutions. Our rules and policies have been developed using a structured approach that has proven successful. To digress from this process sets a bad precedent that other groups may exploit, leaving our markets in confusion.

Question 17: *Alternatively, should Hybrid be required to be modified to fit clearly within the established regulatory framework for either visible or dark liquidity? If so, how?*

Liquidnet feels that consideration of commercial proposals that are not consistent with existing regulations should be undertaken only after careful reconsideration of the governing regulations has demonstrated a need to change those regulations.

Canadian regulators have historically done a good job at balancing the interests of applicants and Canada's need for strong capital markets. Canada's "dark rules" are a recent and excellent example of careful consideration of broad regulatory principles preceding application approval, and one that has rightfully been respected and emulated by other jurisdictions. We believe Canada has an opportunity here to consolidate its global leadership position by applying these same principles again, and would encourage the Commission to do so, providing a clear and considered framework to innovate within.

Thank you once again for the opportunity to share Liquidnet's views and expertise in these areas. We would be happy to contribute further, on any follow-on questions this debate provokes.

Regards

Robert Young
CEO, Liquidnet Canada