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**Re: OSC STAFF NOTICE AND REQUEST FOR COMMENT REGARDING  
PROPOSED STRUCTURE OF TRADING FACILITIES  
FOR A NEW EXCHANGE PROPOSED TO BE ESTABLISHED BY  
AEQUITAS INNOVATIONS INC.**

Scotia Capital Inc. (“Scotiabank”) appreciates the opportunity to comment on the proposed new equities exchange to be established by Aequitas Innovations Inc. (“Aequitas”).

Scotiabank supports innovation in the Canadian capital markets, particularly when it serves to further stable, fair and efficient markets. We share the disappointment of many market participants that recent innovation by Canadian market operators has mainly taken the form of changes to trading fee models rather than novel services, trading mechanisms, and order types.

We are therefore pleased to see a new proposal that considers an innovative approach to addressing some of the issues we currently face with our market structure. We are concerned about many of the same issues that Aequitas is attempting to address: excess intermediation by HFTs, effectiveness of current market making models, and high execution and technology costs.

Despite being in agreement with many of the Aequitas proposal’s stated goals to address predatory trading practices, maker/taker pricing and market data fees, we do have some concerns about whether the proposed structure will be able to sufficiently achieve those goals to warrant the required exceptions to existing regulations and increased technology costs to the industry. We have concerns that approving an exchange model which does not fit into the current framework will require exceptions to the OPR structure and will only serve to complicate an already complex market structure without addressing any of the underlying issues.

In our answers to the specific questions below we have attempted to comment both on our concerns with the current OPR structure and our specific thoughts on the Aequitas proposal.

*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?*

In our opinion OPR does not need to be extended to all lit markets. We believe that the current system of full protection for lit markets encourages over-fragmentation of markets, unjustified increases in technology and compliance costs, and forces participants to trade with systems which they may not consider to be beneficial or meaningful.

The Aequitas lit book would be the ninth protected lit book in Canada, a number that is grossly disproportionate to the size of the marketplace. The argument of OPR protection being necessary to foster competition has been over extended and it now is encouraging new entrants of uncertain value and significant cost.

Scotiabank would like to propose an alternative solution where only certain markets would qualify for protection, but all markets would be able to compete for order flow.

We would suggest that OPR only be extended to lit markets that meet some combination of the following criteria:

- Must meet a market share percentage threshold for some period of time first to demonstrate ability to operate and deliver value to the industry.
- Must not charge for market data which participants are required to consume.
- May not pay a significant passive rebate since orders are then not truly offering to trade at the indicated price.
- Must provide fair and equal access to all.
- Must accept some level of liability for errors made by the marketplace operator.

We are very concerned about continuing to approve new protected marketplaces without first addressing the larger structural issues we see with the OPR. Each new market that is approved incurs additional costs for the industry including development, testing, connections, market data, and surveillance. In addition they make our market more complex and would make it harder to implement a new OPR framework at a later time.

If broader rule changes are not being contemplated in the short term for OPR, we would suggest that a pilot project which allowed the Aequitas Lit book to be approved as an unprotected marketplace could proceed until specific changes to OPR can be formally tabled.

*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?*

No. We do not think that protection should apply to a market which excludes some market participants and does not publish depth of book. In fast moving markets Hybrid would be continually publishing new quotes at different price levels. It would be very

difficult for compliance systems to deal with this and take into account the SME factor. SORs would have similar issues and those using bypass orders would be unable to displace shares outside of the NBBO on Hybrid.

*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?*

The data published by Hybrid should be made available to all market data vendors but it should not be considered for the purposes of determining the regulatory best bid or offer.

*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?*

The reference price should not include Hybrid, regardless of whether OPR applies to the hybrid.

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

We view visible versus non-visible as immaterial to fair access - something doesn't become fair just because people cannot immediately see what they are being excluded from.

If exemptions are contemplated for non-displayed markets we fail to see why they wouldn't be considered for non-protected lit markets as well. There would be issues to be dealt with if this was implemented but we feel that these are worth addressing rather than simply preventing potentially beneficial market models from being launched.

In line with our answer to Question 1, we feel that more restrictive criteria should be used to determine which markets are protected. Those protected markets should be required to provide fair access as it exists now with no restrictions permitted.

For non-protected lit markets we believe that exceptions to fair access could be allowed and we discuss this further in Question 6 below.

*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?*

Visible protected markets must be fully accessible by all market participants.

For non-protected markets we believe that in certain circumstances exceptions are warranted. In these cases however we believe that the ability to post resting orders to any market must be fully accessible with no restrictions. There is a case to be made however that exceptions should be made to allow restrictions on active orders on non-protected markets, lit or dark.

Market participants are prepared to bid at higher prices to trade against orders from certain types of participants, for example preferring to trade with a retail client, or preferring a buy side institution's order over a dealer's inventory order. These prices would not be available to the other participants, since they are order flow specific and based mainly on expected outcome after a trade is executed (e.g. have I just sold the first 100 shares to a 100,000 share buy order?). When all order flow is allowed to participate equally in a market, posted bids and offers will reflect some sort of probability weighted price based on the expected types of order flow and anticipated outcomes.

We would point to the success of Intraspread (before the revised dark rules), the rebates and price improvement paid to retail order flow by market makers in the US, and the usage of restricted access pools such as Liquidnet as examples of demand for the ability to show premium bids or offers to certain types of flow. This is a reasonable and largely expected component of the market. Encouraging this matching to be done on transparent, visible marketplaces is preferable to having it be done in dark pools and internalization networks.

Exceptions to fair access should be clearly defined and targeted to categories of trading or types of clients to ensure fairness across participant types. Access restrictions must not be allowed that would permit the exclusion of particular dealers, clients or other specific market participants.

The dynamics of this are such that we do not foresee negative impacts on confidence and market integrity. The market is eager to offer the best trade prices to specific participants and having that matching done on visible markets should encourage confidence and market integrity. As long as all markets are restricted to trade at or within the protected NBBO and that published consolidated NBBO quotes only reflect protected markets then the most confusing case for a client's active order will be a price improved fill, which we see as manageable.

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

Proposed restrictions on Hybrid are not consistent with current application of the fair access requirement since it restricts access to a lit market, but might be consistent with the model we proposed in our answers to questions 5 and 6.

We are concerned though that the use of the SME marker to determine who is restricted is not appropriate since it captures a wide range of types of participants, is inconsistently applied and would be susceptible to abuse. See our answer to Question 8 for more details.

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

Scotiabank feels that further information should be requested from Aequitas as to the type of behaviours they are trying to restrict in order to determine if the SME marker is an appropriate mechanism to achieve that.

The SME marker was created to distinguish between market participants intending to enter an actual short position in a stock versus those who are engaging in arbitrage or very short term trading that result in a (neutral) or nominal position at end of day. We believe that currently most of the orders that Aequitas might consider “predatory” use this marker, but this marker is also used by other market participants who do not engage in the targeted strategies but would still be excluded from accessing liquidity on the dark and hybrid books.

We also have concerns that if Aequitas is successful it will encourage avoidance of the SME tag. The SME tag relies on specific criteria around arbitrage, automation and “nominal” positions. Strategies could be modified to no longer fit the criteria for SME or the problematic strategies could be overlaid in the same account as non-SME strategies to avoid having to use the marker.

The SME tag currently works as an information tool because it is a mildly beneficial tag (allows you to not identify short vs. long sales on individual orders) so traders are incented to want to use it if possible. If traders are incented to want to be non-SME it could hamper the tag’s current functions and devalue short interest reporting in our market.

While the “retail” classification is also somewhat problematic, allowing only retail flow to be active on Aequitas would be a cleaner solution in our view. As an alternative to excluding specific types of trading we would suggest modifying the trading mechanism or other market features to make it unattractive to the problematic HFT behaviours they are trying to avoid instead of trying to specifically identify and exclude them.

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

The 100% participation rate proposed for market maker priority in the dark and hybrid books is too high, particularly if either book is protected. Allowing the market maker to get a full fill once broker preferencing is satisfied could risk crowding out any other participants. Allowing the market maker to participate with preferential priority on a smaller portion of their order would be a reasonable accommodation and allow other orders in the book to still have access to some of the inbound liquidity.

*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?*

As discussed in Question 9, we are concerned about giving market making orders full priority, after broker preferencing, in the dark and hybrid books. We do not however have an issue with market makers earning that priority in the related books by fulfilling market making obligations in the lit book. This is particularly true if the Hybrid and dark books are unprotected. The market making model must however be fairly constructed for this to be a reasonable structure. For the most part we are willing to allow market forces to determine if the unprotected markets are going to be successful since presumably if the market making priority becomes unreasonable other participants would cease to post orders there.

*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?*

Market making trading strategies are employed today by a variety of participants on all of our markets and outside of formally sponsored models. We are not concerned about a marketplace putting a market making model in place that would promote liquidity on securities which they do not issue. Though a marketplace providing market making on an issuer's shares may be an incentive for them to list their shares with a particular exchange, we do not expect that another marketplace also providing that service on those shares would be problematic for any market participants, including issuers, as long as the market making model is fairly constructed.

*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?*

We do not expect that allowing DEA clients to be formal market makers introduces any material new risks to the market. The sponsoring broker would still be ultimately responsible for the actions of their DEA clients and would be required to monitor their activities the same as they do for any other client. As long as the DEA client is a member of an SRO or otherwise subject to appropriate regulatory oversight in an IOSCO signatory jurisdiction then there should be sufficient regulatory enforcement recourse to address any issues that arise.

The reality is that the likely DEA market makers are already effectively making markets in Canada, just without any formal responsibilities to go with their activities. As long as the market making model is design to provide a fair balance between responsibilities and benefits then we do not have a specific concern about allowing DEA clients to participate.

*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?*

We do not see how this would create an un-level playing field. The requirements being applied to market makers should be applied equally, either directly to the registered dealer or via the sponsoring dealer to the DEA client.

The only slight advantage we see would actually accrue to the registered dealer since they could integrate required risk checks into their market making systems whereas a DEA client would have to go through some form of risk check system operated by their sponsoring broker. The DEA client would still have the option of becoming a directly regulated dealer in Canada to avoid this extra hop, as many of them have already done in the US, which would negate this slight advantage.

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

As long as the Hybrid is not a protected market, access to post remains open to all, and market makers are not given full priority after broker preferencing then we do not see overly material impacts on market quality and integrity. Ideally a successful launch would in fact incentivize other marketplaces to address investor concerns by modifying existing services or offering new options.

If the Hybrid market ends up being protected then we would see issues with the appearance of trade throughs when SME participants trade through Hybrid. It may also make for confusing consolidated quote activity as the Hybrid continually revises its published quotes based on the current NBBO.

We do see potential impacts though if the Hybrid book and the similar competing offerings that will almost certainly be launched by existing market operators manage to capture a large percentage of overall marketshare. We believe that this is a realistic possibility given the issues with our current OPR market structure.

As we have outlined in this letter, we believe that changes to OPR that would allow lit non-protected marketplaces with differential access rules are warranted. However making those changes without a proper OPR review risks further complicating our market structure, generating significant unintended consequences, and making any corrective changes to OPR that much more difficult to implement. It is for this reason that we would prefer to see a proper review of OPR done before the approval of any new markets, and particularly ones that require exceptions such as those required by the Hybrid book.

*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.*

Please see Question 14 for our thoughts on the relevant risks and the need for a proper OPR review prior to the approval of further marketplaces.

We would also note that in terms of the actual Aequitas proposal, we have significant concerns about whether the use of the SME marker to restrict active orders will have the desired effect. In light of that, we believe the benefits of the current proposal are limited and may not outweigh the potential risks and implementation costs that would be borne by the market as a whole.

*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?*

Please see Question 14 for our thoughts on the relevant risks and the need for a proper OPR review prior to the approval of further marketplaces.

If Hybrid is approved however, we see fairness issues with effectively preventing any competition to Aequitas during a 'pilot' period.

*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?*

Modifying Hybrid to fit the current dark or lit regulatory frameworks would remove the core purpose of the Hybrid book. It would need to be a dark book to currently allow any sort of differential access for active orders and we think it is unlikely that the market makers on the lit Aequitas book would see preferential treatment in a book that requires providing half or full tick price improvement as a meaningful enough benefit to offset their market making responsibilities. The result would be simply more books that further fragment our marketplace without providing any meaningful benefit.



## *Conclusions*

We strongly believe that OPR as it stands has some significant issues that need to be addressed. We feel that this should be done prior to allowing further markets to be established, particularly if they will require exceptions to the current framework. We have made some proposals here on potential modification to the OPR framework but expect that a thorough review of various options is warranted. We are concerned about the time that any review and subsequent regulatory approval process will take and would urge the OSC to expedite the process as much as possible.

Aequitas would represent the ninth protected market in Canada, which represents a very high level of fragmentation for the liquidity available in Canada. In terms of the actual submission by Aequitas, our primary concern is that the proposed use of the SME marker will not achieve their stated goals of eliminating certain HFT behaviours. As such we are not clear that it will bring enough of a material benefit to the market to offset the increased technology costs and market complexity that it would cause. Approving the lit, dark and hybrid books as unprotected markets may be an appropriate compromise since it would allow market participants to then determine for themselves if there is value in connecting to the market.

As always, we appreciate the opportunity to provide our comments and commend the OSC on putting the proposal out for comment at this early stage in its review. We would also be pleased to provide any additional information or answer any further questions you may have.

Yours Sincerely,

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