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GLOBAL BANKING AND MARKETS

December 10, 2012

Market Regulation Branch
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To Whom It May Concern:

Scotia Capital Inc. ("Scotiabank") is a Participating Organization ("PO") and an Investment Dealer and member of the Investment Industry Regulatory Organization of Canada ("IIROC"). As a PO we are acutely aware of the challenges that exist in the Canadian Capital Markets and we appreciate the opportunity to respond to the Ontario Securities Commission ("OSC") with regard to the "Notice of Initial Operations Report and Request for Feedback" (the "Notice") dated November 8, 2012 for CX2 Canada ATS ("CX2"). Scotiabank has two very specific concerns that we would like to share that we would like to share with you regarding the notice.

Broker Preferencing ("preferencing")

Scotiabank is in favor of preferencing as it provides as a method of internalizing some order flow which increases efficiency and effectively reduces settlement costs. Notably, other Exchanges have been matching orders utilizing preferencing functionality for many years; as such, we do not see preferencing as a new concept. However, we do have concerns with the proposed usage of preferencing by CX2 in relation to certain strategies that are undertaken by POs; more specifically, the utilization of the anonymous broker id.

We understand from the notice that CX2 has built functionality to allow a PO to opt-out of preferencing on an order by order basis only. The current notice proposes that the default would match orders using preferencing for all order types, including anonymous. Scotiabank feels that this may have consequences that have not been appropriately addressed.

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The concept of anonymity and the loss of what may be otherwise considered a confidential trading strategy is one of our primary concerns with this operational change. Other marketplaces that conduct preferencing do not match visibly displayed orders against anonymous orders entered from the same PO for a good reason. This treatment guarantees that the anonymous order cannot be indirectly identified by other market participants, and thus, ensures confidentiality. Orders that are tagged anonymously are done so to protect a trading strategy and/or to ensure the confidentiality of a particular buyer or seller. We feel that the loss of preferencing in this instance is a known and reasonable trade-off.

The second concern we would like to raise regards the administration of the opting out of this anonymous preferencing. Opting out on a trade-by-trade basis requires the individual handling the order to appropriately tag it, and various order routers in the trade path to pass-on this tag correctly as orders are sprayed to various destinations. This is a complex and error-prone method. Scotiabank feels that the default behavior should be non-preferenced anonymity, with the option to opt-in to anonymous preferencing if desired and appropriate. It is not known at this time whether it is possible to apply technology resources to achieve a default opt-out position. In any event, resources will need to be assigned to explore all options and to evaluate the costs associated with both; regardless, it may be problematic to meet a mid-December deadline given other resourcing commitments.

Technology Resources and Costs

Each time a new marketplace is created, or an existing one proposes an operational or functional change, there are resources that must be assigned within the PO to ensure that connectivity occurs and continues. Currently, the supply of these resources is extremely tight given the current implementation demands for other industry initiatives such as the roll out of National Instrument 23-103. Redeploying these resources causes time delays and increases the likelihood of deadline failure.

Realistically, there should be a cost-benefit analysis done before mandatory marketplace changes are allowed, given that these actions incur additional expense for the industry, much of which is not borne by the marketplace itself. Additional costs, exclusive of the above, include but are not limited to:

- Market data costs;
- Validation and messaging protocol maintenance costs;
- Connectivity costs;
- Additional vendor costs for potential programming changes (additional blotter codes etc.).

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Soft costs that are incurred include testing, integration, training, policy and procedure deployment and increased surveillance of trading personnel.

We would like to highlight that TMX did not charge extra for its market data when they launched TMS Select. This is an important precedent that the OSC should take into account when reviewing the CX2 application.

Conclusion

Scotiabank believes that competition among marketplaces is essential to foster efficiency in trading and order execution. However, each new marketplace provides a diminishing marginal value to the trading landscape, while imposing a series of accelerating marginal costs upon users. These costs can only be borne by the biggest and wealthiest POs, pushing the externality of these costs to another part of the competitive trading landscape.

Before a new market place is allowed to begin operations, or an existing marketplace is allowed to make mandatorily adopted changes, we would suggest that a study of the costs that are associated with the creation or change should be completed. These costs should subsequently be compared to the additional value proposed in the trading chain. A valuable question to ask would be: Will this result in a more efficient and competitive capital market?

Alternately, we would like to suggest that the OSC consider granting POs a safe harbour from the "protected" status of NI 23-101 until such a time as the new marketplace has been able to demonstrate sufficient market share (high watermark) to warrant the requirement to monitor and canvass that marketplace. Scotiabank is conscious of the competitive hurdle this applies to marketplace changes, and recognizes the regulator must consider this fact in a balanced way. The establishment of a high watermark should work in the converse as well. A marketplace that falls below a specified level of market share for a specified period of time would again trigger the safe harbour allowing POs to suspend their support and terminate connections.

On a final note, we would like to express our concern that there needs to be greater lead time and planning around "go live" dates, especially given the technology resources necessary to facilitate the connection and deployment. We are especially concerned given the myriad of change control issues involved in marketplace changes, and the recent events involving Knight Trading in the US.

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In closing Scotiabank appreciates the opportunity to comment and appreciates that the OSC must review numerous comment letters regularly and as such we are willing to discuss any of the content of our letter with you should it help to clarify our points. Please feel free to contact the below undersigned either by Email at myran.faust@scotiabank.com or by telephone at (416) 862-3891.

Yours truly

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