



September 27, 2013

Market Regulation Branch
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Via email to: marketregulation@osc.gov.on.ca

Copy to:

Randee Pavalow
Chief Compliance Officer & Legal
Aequitas Innovations Inc.

Via email to: randee.pavalow@aequin.com

Re: OSC Staff Notice and Request for Comment Regarding Proposed Structure of Trading Facilities for a New Exchange to be Established by Aequitas Innovations Inc.

Dear Sirs & Mesdames,

I am writing on behalf of True North Vantage and its parent, Select Vantage, in response to the above noted OSC Staff Notice and Request for Comment and thank the OSC for providing market participants with the opportunity to provide comments on what may be a very important initiative for Canadian capital markets.

Our corporate group represents on average approximately 10% (double-counted) of all volume traded across all Canadian marketplaces.

Before answering the questions in a more detailed way, we would like to start with following general comments:

- We welcome the Aequitas initiative as it represents a refreshing approach to marketplace offerings by proposing truly innovative solutions to issues our markets are currently facing. The Aequitas offering is not based on another variation of trading fees or a technology that shaves off additional microseconds from an order round-trip, but it proposes a truly new marketplace model that will benefit its core stakeholders.
- We are very supportive of the fact that Aequitas acknowledges the importance of true liquidity in markets as only designated market makers can provide. The Aequitas approach to market making also recognizes that there is a need for adequate compensation to allow market makers to fulfill meaningful obligations and that such compensation can no longer be provided by rebates and/or discounts, which are now the mechanism used to incentivize High Frequency Trading.



- Finally, we believe that regulators should embrace innovation and support new initiatives even if that requires a change in existing interpretations of marketplace regulation. The regulatory process should enable innovation as much as possible, provided adequate monitoring and ability to take corrective action are in place.

Please find below our answers to the questions.

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?

We do not believe OPR needs to apply to all visible markets and that there are circumstances where liquidity may be enhanced without investor confidence in the markets suffering.

We believe the specialized market segmentation proposed by Aequitas in its Hybrid book will promote enhanced liquidity for certain types of orders that are currently disadvantaged by “predatory” order flow. In other words, investors interested in trading in the Hybrid Book will have the ability to trade-off their current experience of receiving rapid fills on a small portion of their intended traded volume and then watching the market moving away from them as predatory traders surmise the extent and direction of their intended trade volume, against a longer but more certain execution of their desired volume at or within the NBBO.

OSC Staff, at page 12 of its Notice, remarks as follows: “An underlying principle of OPS is that *all* visible orders will be accessible to *all* parties. This is key to having an effective order protection rule – without accessibility, investor confidence may be hampered because of the potential for confusion about why the best prices were not in fact executed.” OSC Staff then give two examples in footnotes 38 and 39 of an active SME order trading on an away market and trading through a better priced quote in the Hybrid Book. This issue should not be of concern to participants and investors in Canadian capital markets:

- SME account-holders (who are all by definition sophisticated arbitrageurs, market makers, HFTs or dealer-principal traders), knowing they are precluded from taking liquidity from the Hybrid Book, will not look upon any such trade-throughs as “missed opportunities” - since passive order flow will only “show its hand” in situations such as offered by the Hybrid book and will be otherwise deterred from trading in a regular lit market, SME account-holders can hardly complain of these missed trades;
- non-SME investors and market participants who are connected to Hybrid will, of course, have made the trade-off referred to above of passively posting to a marketplace where they will not interact with SME flow; and
- non-SME investors and market participants who are not connected to the Hybrid Book may see better-priced liquidity traded through (depending on the extent to which Hybrid trades are integrated into data feeds – see comments below) but, since it will not be their own quotes that are traded through, how will they become discouraged with trading in Ontario capital markets? If they wish to access such better-priced liquidity, they can of course connect to Hybrid.



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?

For simplicity of OPR monitoring and basic fairness, OPR should not apply to Hybrid. That is, active non-SME orders should not be obliged to access best-priced liquidity displayed orders on Hybrid, but they would need to consider Hybrid from a best execution perspective if the type of liquidity routinely traded on Hybrid is of sufficient interest to justify the expense of connecting.

For example, assume the best bid/best offer in a stock is \$9.98/\$10.00 on all protected markets, but an offer is showing at \$9.99 in Hybrid. If a market participant with SME order flow (which is precluded from active participation in Hybrid) wishes to buy at \$10.00 on a protected market, that participant will have crossed the Hybrid offer, even though the participant was precluded from interacting with that order. Accordingly, this is not a “true” trade-through. However, if a non-SME market participant does the same, should it be considered a trade-through? How much in extra resources will IROC have to devote in parsing between SME trade-throughs versus non-SME trade-throughs of Hybrid?

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?

As Hybrid should not be subject to OPR, its quotes should not be incorporated into the consolidated display of the Information Processor. All parties requiring so should however be able to have access to the Hybrid quotes to allow them to ensure they comply with their best execution obligations.

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?

If the Hybrid is not a protected quote, it should not be considered in establishing a reference price for other purposes. From the perspective of simplicity and ease of reference, the NBBO should reflect the common “best price” that all market participants have access to if they trade in protected markets. To the extent market participants trade away from the protected markets, they have a clear and visible benchmark against which to compare their trade executions.

5. How should fair access requirements be applied with respect to access to visible marketplaces?

We make two important observations about the fair access requirement found in NI 21-101.

First, it is not limited to visible marketplace, but applies to all marketplaces. There is no suggestion that visible marketplaces have a different fair access standard than, say, dark or hybrid marketplaces.

Second, the fair access requirement is not an “equal access” standard that prohibits any limitation on access to marketplace services. Rather, it requires that marketplaces not “...*unreasonably* prohibit, condition or limit access by a person or company to serviced offered by it [emphasis added]”. In other



words, certain investors and market participants may have their access to a marketplace limited or even prohibited, but only if such limitation or prohibition is “reasonable”.

One form of obvious limitation that is applied by most of the Canadian marketplaces is the restriction of direct membership to registered dealers. Given the desirability of having members whose capitalization is strictly monitored by IIROC, and the desirability of having members who specialize in, and are accountable to IIROC, for monitoring client order flow, this is an obviously “reasonable” limitation on access.

One marketplace, LiquidNet, excludes registered dealers from being members and allows IIROC member firms to participate only in certain circumstances. This limitation of access is also accepted as “reasonable” no doubt because LiquidNet’s strategic purpose is to facilitate the ability of institutional buy-side firms to conduct the type of block trading that on lit markets would involve too much detrimental information leakage.

By comparison, Aequitas does not even single out organizations but *strategies of trading* – i.e., active SME order flow that frequently acts in a “predatory” manner. As long as this rationale governs Aequitas’ access rules, we believe such a restriction is at least as reasonable as the other market precedents mentioned above.

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?

See response to Question 5. In addition, we believe that the approach proposed by Aequitas would not only *not* undermine confidence and market integrity, but on the contrary promote it by allowing a safe harbor for larger institutional traders and others wishing to avoid interaction with “predatory” order flow.

7. Are the access restrictions proposed for Hybrid consistent with the application of the fair access requirements?

See response to Question 5.

8. Is the SME marker an appropriate proxy to identify the behaviors Aequitas seeks to restrict?

It may not be a perfect marker, but it does reasonably demarcate the type of trading that is reasonably likely to be “predatory” – in other words, trading that seeks to gain advantage from the information leakage inherent in passive order flow on lit markets. Aequitas should consider refining it over time as and when certain SME-marked order flow can be shown to be safely non-predatory, but it is a good starting point.

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



True market making is a critical component of a marketplace and the approach proposed by Aequitas acknowledges the need to adequately compensate market makers for the risk that they take and the service they provide in price discovery. It will however be important for Aequitas to ensure that benefits and obligations are adequately aligned. If they don't do this, they will impact their own chances of success.

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?

Market making is by definition a service provided in a transparent book to help with price discovery and to establish a liquidity safety net. It seems reasonable to us that market makers receive, as partial compensation, priority in the Dark and Hybrid books.

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?

Any initiative that would promote and facilitate market making should be supported. Restricting market making to the market on which the security is listed seems an arbitrary restriction when compared to the current regulatory regime of permitting trading in exchange-listed securities on multiple marketplaces.

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?

Adding additional market making capability to the Canadian marketplace would be beneficial for all issuers and investors. On the other hand, appropriate regulatory oversight must continue to exist. The balance can be struck by allowing DEA client market makers, provided they are sponsored by an IIROC member and subject to appropriate oversight by that IIROC member.

Moreover, this is akin to the current commercial practice of many sponsoring IIROC members whereby they "pass through" credits earned by DEA clients that execute passive orders through the sponsoring member. The economic inducement to post – the credit – is enjoyed by the DEA client, albeit subject to the gatekeeper oversight of the sponsoring IIROC member firm.

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 don't see a fairness or market integrity issue as long as the DEA client market makers are subject to appropriate oversight by their sponsoring broker, much as is the case with sponsored access trading generally.



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

We don't see believe there will be any detrimental consequences as to the quality and integrity of the visible market as whole. On the contrary, if Aequitas' proposition is successful, we would expect it to have an overall positive impact on market quality and integrity by increasing the liquidity traded by firms that are currently front-run by predatory strategies and thereby leading to more reliable liquidity across the board.

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.

What Aequitas proposes is a model that seeks to minimize the effect of predatory strategies and promote true market making. This will be beneficial to reliable liquidity and will promote investor confidence.

We have not immediately identified specific risks resulting from the proposal, but would expect regulators to closely monitor any unintended consequences and act appropriately should there be a negative impact.

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?

We don't believe a pilot is warranted because of the risk that some market participants will seek to influence it, as they know it to be limited in time. In the very least, a pilot may lead some market participants to sit on the fence until there is a conclusion and this too would impact the reliability of any results. Either the model is acceptable from a regulatory standpoint – which we believe it is – or it isn't.

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?

Forcing Hybrid to fit in an established regulatory framework brings us back to a new market that is similar to what we already have today. This would not be materially beneficial to market participants. Such a *status quo* approach will suppress innovation in Canadian capital markets in the long term.

* * * * *



In conclusion, we believe that what the Canadian capital markets need is more choice in market micro-structure, not just more competition between substantially similar marketplace models. That is why we are supportive of the Aequitas Proposal as it provides the opportunity, for those who desire it, to have access to solutions currently not available.

We would be happy to provide any additional information on request.

Kindest regards,

A handwritten signature in black ink, appearing to read "D. Schlaepfer".

Daniel Schlaepfer
President