CANADIAN SECURITY TRADERS ASSOCIATION, INC.
P.O. Box 3, 31 Adelaide Street East
Toronto, Ontario M5C 2H8

August 2nd, 2016

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

and

Mark Faulkner
Vice President, Listings and Regulation
CNSX Markets Inc.
220 Bay Street, 9th Floor
Toronto, Ontario M5J 2W4
Mark.faulkner@thecse.com

Re: CNSX Markets Inc. – Notice of Proposed Changes and Request for Comment: Fee Proposal Related to the Guaranteed Minimum Fill (GMF) functionality

The Canadian Security Traders Association, Inc. ("CSTA") is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling and trading of securities (mainly equities). The CSTA represents over 850 members nationwide, and is led by volunteer Governors from each of three distinct regions (Toronto, Montreal and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world.

This letter was prepared by the CSTA Trading Issues Committee (the "Committee", "CSTA TIC" or "we"), a group of 20 appointed members from amongst the CSTA. This committee has an approximately equal proportion of buy-side and sell-side representatives with various areas of market structure expertise, in addition to one independent member. It is important to note that there was no survey sent to our members to determine popular opinion; the Committee was assigned the responsibility of presenting the views of the CSTA as a whole. The views and statements provided below do not necessarily reflect those of all CSTA members or of all members of the Trading Issues Committee.

The Canadian Security Traders Association appreciates the opportunity to comment on the proposal by CNSX Markets ("CSE") to change the trading fee model applicable to passive marketplace participants trading in Designated Securities (the "Fee Proposal"). Under the Fee Proposal, the fees passive participants pay would be dependent on whether or not the active orders against which they trade are GMF eligible (GMF Orders). We are generally supportive of competitive marketplace solutions and innovation in the trading landscape. However, based on the analysis that we will present, we believe that this proposal has notable areas of concern with regards to fair access and leakage of information and that it should therefore not be granted regulatory approval.

Fair Access

In our opinion, it is inappropriate to offer differential pricing for precisely the same fill in the lit market depending on the nature of the counterparty. In April 2013, Alpha Exchange ("Alpha") made a similar proposal that was subsequently denied regulatory approval. Whether the differentiated fee is applied to an order that is executed passively (CSE's current Fee Proposal) or actively (Alpha's proposal which was denied), this does not change the underlying rationale.

We believe that it is unfair to passive participants to have their fees determined by the nature of an incoming order and not by their own actions or decisions. While it can be argued that those that wish to maintain certainty of pricing for their passive orders can simply choose to post on other marketplaces other than the CSE, this reasoning is only palatable because it is being proposed on a market with low market share. If a similar dual fee schedule were to be proposed on a marketplace with relatively large market share, arguing that passive orders could simply decide to post on other markets for certainty of fees would be deemed unreasonable since there would be major potential impact to execution quality by having to avoid posting on a market with large market share.

The CSE states that it "*does not believe that the variable fee outcome affects the trading economics for the client: whether the trade receives a rebate or is charged a fee, [they] are unaware of any circumstances where the impact of the fee or the benefit of the rebate is reflected on the client's trading outcome*." While the CSE is referring to retail clients in this statement, it is important to assess the impact to institutional clients as well. While institutional investors still generally do not directly capture marketplace fees/rebates in their commission fees, institutional commission rates remain underpinned by these execution costs, as do the relative profitability of the broker-dealer firms who sustain them. It is not reasonable to assume that fees/rebates are not passed on to institutional/retail clients in order to justify the existence of a new feature.

The CSE also states that "*from the advent of multiple marketplaces in Canada, one fact is abundantly clear: resting agency orders are almost invariably posted to the listing exchange. In the case of the CSE, all orders in TSX and TSX-V-listed securities come from proprietary sources.*" While the majority of agency retail resting orders continue to be posted to the listing exchange (rightly or wrongly), agency institutional resting orders commonly post on various markets. To imply that <u>all</u> agency resting orders on CSE are from proprietary sources is false since institutional agency orders can and do rest orders on the CSE, amongst other markets. A marketplace feature should not be approved under the assumption that agency orders would never rest orders on a given market, especially if that market were to garner a significant amount of market share.

Information Leakage

The CSE is proposing to allow participants that provided passive liquidity to identify the type of counterparty they interacted with (GMF Eligible (aka Retail) or GMF Non-Eligible (aka Non-Retail)) at the end of each day by reverse engineering the fees they pay on a trade by trade basis.

Allowing passive participants in the CSE to assess the presence of non-retail active flow may be indicative of large directional multi-day orders and allow those particular participants to construct a mosaic of institutional activity. We believe that any marketplace feature that allows information leakage can be directly damaging to the execution quality received by institutional clients should not be allowed.

Since counterparty identification (Retail vs Non-Retail) places the passive participant who is party to the execution in a privileged position of having information that is not broadly available to the market, this is an issue that also has fair access concerns. Passive CSE participants would not only have unfair informational advantage vs other passive liquidity providers on other markets, this advantage would also exist over CSE liquidity providers who have yet to receive a fill.

It is important to note that the information disclosed by trading with the CSE GMF facility and TSX MGF facility is not equivalent to the information leakage we perceive in the Fee Proposal at hand. The CSE is proposing to provide fee information that allows for the reverse engineering of the participant type (retail vs non-retail) for all fills, whereas the current TSX MGF and CSE GMF only allow for identification when a trade is executed within the Minimum Fill facilities themselves. While we do not specifically condone the existing minimum fill functionality, we believe that it is important to highlight the dissimilarity.

It may be argued that institutions could avoid the information leakage caused by the Fee Proposal by avoiding trading on the CSE completely since its market share is currently under the 2.5% threshold that will be required to have protected quotes under the new OPR rules (effective Oct 1st, 2016). We do not believe that it is reasonable to expect that institutions could systematically opt out of routing active orders to the CSE since they would have to respect their responsibility to achieve best execution by balancing the advantage of the available liquidity with the information leakage that fills on the CSE would trigger. Even if the majority of institutional orders did avoid routing to the CSE, we do not believe that this kind of intentional segmentation of order flow is healthy for the Canadian markets. In addition, if the CSE were to become a protected market in the future, then there would be no way for institutional participants to “opt out” of trading on CSE on the basis of this risk of information leakage. Either way (protected or not), there is relevant information leakage involved that cannot be avoided.

Conclusion

Our interpretation of the Fee Proposal is that the main perceived benefit will stem from a decrease in trading fees for brokers that execute orders on behalf of active retail participants (GMF eligible). We believe that this benefit will come at the expense of relatively higher trading fees for brokers that provide execution services to institutions. We also believe that the Fee Proposal will cause information leakage for institutional orders and thus a potential increase in execution costs for the end clients of those institutions. While there is certainly a value to ensuring that brokers are not held captive to a market structure that imposes undue costs onto them, this does not mean that decreasing costs for brokers that cater to retail investors should be prioritized over an increase in costs to institutional investors. Promoting liquidity provision to small retail participants should also not be acceptable at the expense of additional costs to institutional investors, especially considering institutional investors represent by far the largest proportion of wealth of the Canadian public.

Thank you for your attention in this matter.

Respectfully,

“Signed by the CSTA Trading Issues Committee” c.c. to:

Ontario Securities Commission:
Ms. Maureen Jensen, Chair & CEO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

Alberta Securities Commission:
Ms. Lynn Tsutsumi, Director, Market Regulation

Autorité des marchés financiers:
M^{e} Élaine Lanouette, Directrice des bourses et des OAR

British Columbia Securities Commission:
Mr. Mark Wang, Director, Capital Markets Regulation

IIROC:
Mr. Andrew Kriegler, President and CEO
Ms. Victoria Pinnington, Senior Vice President, Market Regulation
Mr. Kevin McCoy, Vice-President, Market Regulation Policy
MS. Sonali GuptaBhaya, Director, Market Regulation Policy