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BY EMAIL

Dear Ms. GuptaBhaya,

Scotia Capital Inc. ("Scotiabank") appreciates the opportunity to comment on the "Re-Publication of Proposed Dark Rules Anti-Avoidance Provision" published by IIROC on January 29, 2015. While we fully support the proposal's stated goals of protecting the price-discovery process and overall quality of Canadian equity markets, we have some significant concerns with the impact and effectiveness of the proposed implementation.

We see these proposals as protectionist measures that remove natural competitive pressures by limiting orders from routing to the U.S. in their search for best execution, while doing nothing to address the reasons that orders may seek to execute in the U.S. in the first place. Instead of addressing the underlying problems, these changes will make things worse by once again raising costs of execution in Canada and lowering the competitiveness of our market. In general, we are very skeptical of regulation that seeks to put artificial limitation on the flow of orders, particularly in markets as highly integrated as Canada and the U.S., and believe that the inevitable result is market inefficiencies and arbitrage opportunities.

We would strongly suggest that IIROC and the CSA address the underlying problems in the Canadian market instead of dealing with the symptoms. If the Canadian marketplace is believed to be uncompetitive for order flow, the solution is to search for ways to become more efficient rather than attempting to prop up marketplaces with protectionist regulations. The TMX's

proposal for the Alpha marketplace is a direct response to the threat of competition and anti-avoidance would diminish the incentive for marketplaces to provide innovative solutions like this to the Canadian retail trading community.

In this letter we discuss our concerns about this proposal, outline what we see as the existing market structure issues, and lay out our suggestions for addressing these issues and encouraging retail orders to execute within Canada. A high level summary:

- Routing of retail order flow to the U.S. is largely a reaction to the lack of efficient options for retail execution in the Canadian market, as well as excessive costs caused by a combination of small order disclosure requirements and the order protection of marketplaces with excessive maker-take exchange fee models.

- Retail order flow has value to market-makers, due largely to its random nature.

- Canadian regulation makes it difficult for retail investors or brokers to capture that value. The value in Canadian retail order flow currently accrues almost exclusively to HFT market-making firms posting on lit markets and the exchanges that facilitate this activity. This proposal not only prevents retail orders from receiving superior treatment, it puts them at a disadvantage relative to institutional orders which are typically exempt from order exposure requirements.

- The current regulatory structure clearly benefits HFTs and marketplaces at the expense of retail investors, brokers and other market participants.

- The U.S. wholesaler model where retail brokers route directly to market-makers, while not optimal from a market structure perspective, does allow for retail orders to be protected from creating undue market impact by receiving full fills at the NBBO rather than being routed into the lit markets which may not have the size available to fill the order, and will likely attempt to withdraw liquidity as soon as the order is detected.

- We will propose a number of changes that would improve our market's competitiveness without resorting to protectionist measures. These include allowing a lit market which restricts the taking of liquidity to retail accounts, reducing overall maker-taker fee levels, reducing tick sizes and allowing an order to route to an alternate jurisdiction if it is larger than the available NBBO size instead of the arbitrary 50 board lots.

What drives cross-border order routing?

Before discussing whether controls on cross-border order flows are warranted it is important to look at what the factors are that drive this activity.

There are a number of factors affecting the decision to route orders between jurisdictions but the primary ones include:

Factors Encouraging Routing of Orders to Other Jurisdictions

- Access to Liquidity (including preferential treatment of retail orders)
- Access to Better Price (currency converted NBBO)
- Access to Price Improvement
- Trading fees and rebates

Factors Limiting Routing of Orders to Other Jurisdictions

- Routing Complexity
- F/X Conversion and Management
- Differences in Corporate Actions, Dividend Ex-Dates etc.
- Settlement Date Differences
- Settlement Costs – Additional settlement legs, flips between depositories (e.g. DTC to CDS) etc.
- Regulatory Controls

The relative importance of each factor varies depending on the type of order flow and specifics of the order in question but they are always present in any routing decision. It is also important to note that the same factors would apply to orders in the U.S. market that may be routed to Canada for execution.

Given the risk, complexity, and costs involved in routing orders to another jurisdiction, it is generally simpler, easier and cheaper for a broker to execute an order at home. This provides a natural barrier to order flow leaving Canada and should be sufficient to retain the majority of order flow in a properly functioning market.

The fact that there is a concern about large amounts of retail order flow routing to the U.S. indicates that the factors above must be significantly out of balance. In our view, excessive maker-taker trading fees and lack of fair economics available to retail order flow in Canada are the primary drivers of this activity. Any solution must address these issues if it is going to succeed.

Value of Retail Order Flow

Retail flow has a higher value to market makers than other types of flow. Accordingly, liquidity providers will offer better fill prices, guaranteed fill sizes and lower fees to attract this order flow. We believe that retail investors and their brokers should be permitted to capture this value in a transparent fashion as it is a significant benefit to them and regulatory attempts to prevent this create significant market complications and distortions as market participants try to replicate the economics in other ways.

Active retail order flow has value to the market-maker who executes against it primarily due to the random nature of retail order flow as compared to institutional order flow. Retail orders are generated by thousands of different people, so there is a higher probability that any particular

buy order will be followed by a sell order, whereas for an institutional order, an initial buy of 1000 shares is more likely to be followed by the balance of a much larger buy order.

In addition when able to trade exclusively against retail orders, the market-maker will not be “picked off” by an HFT active order that has determined from low-latency data signals that the price of a security is likely about to move in a particular direction.

For a market-maker whose aim is to buy at the bid and sell at the ask, random retail order flow is attractive as it affords a continuous opportunity to achieve their objective on a regular and timely basis. Because of this, they are often willing to offer price improvement, and will guarantee to fill all orders of up to a certain size in order to win access to that order flow.

As this is not permitted in the Canadian marketplace, retail investors do not receive the benefits of larger fills, price improvement and lower execution costs. Meanwhile brokers and marketplaces have attempted various strategies to try to replicate these economics:

- Having an internal prop group or HFT client make markets on a high-rebate market and routing retail orders there to match using broker preferencing while avoiding interacting with the rest of the market as much as possible.
- Routing away from Canada.
- TMX’s Alpha proposal is an attempt to isolate active retail order flow on that market so that participants can post orders that are likely to trade against a retail order.

These strategies are overly complex and inefficient ways unlock the value of retail flow but are currently being pursued by various parties due to the restrictions on more straightforward mechanisms for retail order flow. This is inefficient and contributes to the needless complexity of our market structure.

Factors Encouraging Routing of Orders to Other Jurisdictions

As these amendments have been prompted by the possibility of small retail orders being routed to the United States, it should be noted that routing Canadian dollar orders to the United States introduces substantial technological, settlement and foreign exchange complications for a dealer. That IIROC believes that a significant portion of the Canadian retail brokers would still prefer to trade in the U.S. over Canada is a disturbing sign for the competitiveness of the Canadian equity market. In the long run the Canadian market will not thrive unless we can offer a trading experience which is competitive with that of the United States.

We outline below the primary factors driving these routing decisions.

Access to Better Price

Many of the most liquid interlisted stocks typically trade with the minimum one cent spread in both Canada and the U.S.. This means that when deciding which market to route to based on

their respective NBBOs, one market will always be better to buy and the other to sell on a currency adjusted basis (ignoring FX spreads for the moment).

This means that half of all orders on tightly quoted stocks will receive a better price in the United States, by an average of a half cent per share. This is because one market will have a better bid or offer about 50% of the time and the order will receive price improvement of somewhere between $0.0001 and $0.0099 per share. Accordingly smart order routers regardless of business type will choose to route many orders southbound to obtain superior prices.

Given the technological innovations in the equity markets, the penny tick size limit is an antiquated policy. In Canada, minimum spreads range from 2% for stocks trading at 50 cents to less than 1 basis point (0.01%) for stocks trading above $100, meaning that stocks with similar market caps but different notional prices experience a very different market structure. At the low end this is far too large for low-priced liquid names and is essentially a tax on retail investors who typically use active orders as they pay larger than necessary costs to cross the spread.

Access to Liquidity

For many interlisted names the U.S. markets trade as much or more than their Canadian counterparts. Institutional clients have demanded that their orders access U.S. liquidity for as long as there have been interlisted symbols. Before the advent of sophisticated cross border order routers, this was achieved by manually splitting up orders and working a portion separately in both markets.

Large retail orders require similar handling to institutional orders to achieve best execution, but we believe that mid size retail orders would also benefit from access to U.S. liquidity. These orders are often of a significant size but smaller than the 50 board lot threshold required to not be routed directly into the market. This size of order would often be given a full fill by a wholesaler if they were permitted to execute the order. This has the potential to provide significant price improvement over the average price that would be realized on the order if it had to trade with multiple levels of the Canadian book.

In general, we feel that the “dark rules” are a reasonable framework, discouraging excessive fragmentation and promoting open price discovery. The 50 board lot standard, however, does not work well across liquidity levels. For less liquid and/or higher priced names, 5100 shares is too large a threshold. There are many cases where orders for less than this amount are still significantly greater than the size available in the lit markets and the order exposure requirements forces the client to experience adverse price impact from their order.

Retail clients often use market orders and are less likely to have access to algorithms or professional traders, both of which can work to limit the market impact of orders. That wholesalers will promise to fill up to a significant minimum quantity at the US NBBO is a tremendous benefit to retail clients whose orders would otherwise create significant price impact.

To illustrate, consider a market buy order for 4000 shares on a symbol with shares offered in Canada as in the table to the right.

Price	Shares
5.71	100
5.73	1000
5.75	1400
5.77	300
5.79	200
5.82	100
5.83	600
5.84	100
5.85	700

If this order can be fully filled by a wholesaler, the client can receive a full fill at $5.71 or better.

If this order is released into the market, the client will receive an unpredictable fill. It is possible that there may be shares in the dark, however often shares will be withdrawn from the market as soon the order begins to execute (i.e. “liquidity fade”).

If the order receives exactly the fills displayed in the market, they will receive an average price of $5.7685, which equates to a worse execution by $234 relative to the fill available from a wholesaler, in addition to any price improvement received. In some cases other retail or institutional investors will benefit from these fills, however we believe that in most cases this money will accrue to HFT firms as they are the ones constantly quoting most names and can react most opportunistically to market opportunities.

While this is an extreme example, we considered a reasonable representative sample of retail active orders in inter-listed names and found 17% of shares traded were from orders for more shares than available on the visible Canadian marketplace at the time of the order, but for 50 or less board lots.

There is a significant set of retail orders which are disadvantaged by this policy. *Applied across the Canadian retail community, even with conservative assumptions we believe that this adds up to millions of dollars in additional costs to retail investors annually.*

Based on this we would recommend that orders be exempted from order exposure if they cannot be fully filled at the NBBO by displayed liquidity on Canadian protected markets (subject to trade-through regulations). We believe that this would be a reasonable and flexible standard that could see significant execution quality improvements for many retail orders. We would also note that to the extent a Canadian facility was available where participants were incented to post larger sized orders based on only trading against retail order flow, this would raise the threshold where orders would be permitted to trade in another jurisdiction. As we note in a number of places in this letter, we also believe that Canadian orders would naturally prefer to execute against a locally available source of liquidity and should preference the Canadian option over international execution if one became available.

Trading fees, Rebates, Payment for Order Flow and Price Improvement

We have included trading fees, rebates, payment for order flow and price improvement in the same section because when discussing HFTs and wholesalers one must recognize that these are all the same thing. All of these simply represent an adjustment to the price of the trade being executed.

In the example of a retail client buying 1000 shares at $20.00, the market maker selling the shares receives an exchange rebate of 31 mils ($0.0031) per share. Therefore the net proceeds to the market maker (who typically receives the exchange rebates on a pass-through basis from their broker) is actually $20.0031 per share. It is on the client side of the trade where the true price of execution is obscured. The broker in this case pays the high active fee without adjusting the client's trade price so the cost to the client remains $20.00 while the broker pays the additional $0.0035 required to execute the trade.

In the U.S. it would not be uncommon for that same market-maker acting in a wholesaling capacity and executing that same client order to provide both price improvement on the client fill and some sort of payment for order flow in the form of a rebate paid to the retail broker. Let's assume for this example that a wholesaler will provide a combination of price improvement and rebate totalling $0.0015 per share for U.S. retail orders. This leaves the wholesaler with a net sale price of $19.9985. This is a full $0.0046 lower than the price they receive in the Canadian market ($20.0031) as described above– nearly a half penny difference. This means that, particularly on retail flow, Canadians are significantly over paying for their executions versus what would be achievable in the U.S. while interacting with many of the same counterparties.

What we see here is that in the U.S. the wholesaler would be willing to transact with the same retail order for nearly a half penny less than they would in Canada. This is the core issue we have with our current market structure – we are grossly overpaying for liquidity provision.

It is clear to us that wholesalers are willing to pay – in price improvement and explicit rebates - in order to interact with retail orders. What we don't understand is why as a market we believe it is reasonable to then turn around an pay wholesalers/market-makers nearly a third of a penny in passive exchange rebates to execute that same order flow. There is a necessary and important discussion that needs to be had on the fair and appropriate split between client price improvement and broker execution rebates, but what should be much easier to agree on is that as a market we should demand to execute our orders on more fair economic terms with liquidity providers. Our experience in dealing with wholesalers/market-makers has been that they are more than willing to execute on fair terms and would welcome that opportunity to do so in Canada if it increased their ability execute against this type of flow.

We would note that market models where the amount of price improvement and any fee reduction/rebate are standardized for all participants and approved by regulators is likely a better way to manage this potential conflict than in the U.S. where execution terms are negotiated directly between brokers and wholesalers.

Proposed Solutions

1 – Market allowing only retail active orders.

There is a significant difference in the value and execution requirements of retail and institutional order flow. Currently our market structure ignores these differences and forces retail orders to execute at significantly disadvantageous terms. The implied bargain outlined in this proposal is that the significant costs incurred by retail orders, both in price improvement and

explicit fees, for executing in the Canadian market is a reasonable price to pay for liquidity provision by HFTs. We believe that there is a better alternative for our market that does not go as far as the full wholesaler model found in the U.S. market.

We would suggest allowing a lit market in Canada that would only allow active orders (taking liquidity) originating from retail accounts. The Intra-spread dark market was previously allowed to segment flow in this way with some success (prior to the introduction of the dark rules) so there is precedent for doing this. The proposed changes to the Alpha model are also attempting to effectively segment flow using a speed bump to make the market unattractive to non-retail order flow.

We believe that allowing explicit segmentation of active flow in this way would create a market where retail orders could achieve fair execution economics while allowing all market participants – from HFTs to institutional client orders – to post passive orders and compete to interact with retail order flow on an order by order basis. This allows open access for anyone to trade against this flow and allows those passive orders to participate in the fully displayed price discovery process.

2 – Protect NBBO size from routing away

In addition to orders above 50 board lots, we would suggest exempting orders larger than the quantity available at the NBBO on visible protected markets from the order exposure rule. We feel that this would be a logical, scalable standard which provides that orders not be diverted from the lit markets where liquidity is available, while allowing clients to benefit from dark liquidity when the result is superior to that available in the visible markets. We have included the existing 50 board lot threshold here due to the likely complexity of going to a fully dynamic threshold, but whether that remains a reasonable fixed level is something that could be discussed.

3 – Tick Size Adjustment

We suggest rationalizing the tick size to allow Canada to be competitive on both sides of the quote.

Reducing the minimum tick size for lower priced liquid securities would greatly reduce the incentive to route cross-border, provide a competitive advantage for the Canadian marketplace which could display the best price on both sides of the quote, and improve fills for natural investors who disproportionately cross the spread. This could have the effect of both keeping orders in Canada and attracting U.S. orders on interlisted names to be routed to Canada seeking to capture a better displayed price.

4 – Fees – Introduce Maker-Taker Pilot

As we have raised in numerous previous comment letters and our client market structure commentaries we believe that maker-taker pricing models are highly inefficient, resulting in distorted and fragmented markets. The current high level of maker-taker fees allowed in the Canadian market causes an excessive level of intermediation by market making HFTs and

results in significantly higher costs for most other market participants. It also creates conflicts of interest for brokers and is effectively a method for subpenny trading for certain participants.

We would note that though inverted "taker-maker" fee structures where active orders receive rebates do exist in Canada they tend to have limited liquidity. In our experience these venues are primarily used by HFT market makers as a form of sub-penny price improvement. When a stock develops a large order queue on the TSX and other high passive rebate markets we see HFTs start posting on inverted venues to in effect offer to trade at a slightly better net price than the other markets. In the case of a market where active orders can be limited to only retail accounts we would expect to see significant liquidity posted on an inverted venue. In the absence of that structure we do not expect these markets to capture significant market share.

The single most effective change that could be made to our market would be the elimination or aggressive capping of maker-taker fee models. In our view the current proposed cap of 30 mils is not a meaningful step and essentially allows the status quo to continue.

Regulators in the U.S. and Canada are looking closely at this practice and hopefully this factor will go away in the near future. At minimum, orders which are not genuine offers to transact at the displayed price should not receive the same protection as bona fide orders at that price. For example, an HFT posting a bid of 12.50 on the TSX is really offering to trade at a price of 12.4969 as they will receive a rebate of 0.0031. Accordingly, they should at most be considered a protected bid at 12.49. That the order protection rules treat this order the same as a genuine offer to transact at 12.50 creates a significant distortion in the marketplace.

We strongly suggest that IIROC and the CSA follow through and implement the proposed maker-taker pilot study. We believe that eliminating maker-taker on a significant cross section of Canadian securities would clearly demonstrate the detrimental impact that these fee models are having on our market and would remove a significant motivation for orders being routed to other jurisdictions.

5 - OPR

We were very optimistic when the CSA proposed a number of potential changes to the Order Protection Rule framework last year. The proposed changes would have limited 'protected' status to only marketplaces that qualified based on market-share percentage or some other set of criteria as well as making other significant improvements. We were generally supportive of the proposal and view these changes as critical for our market.

We have been disappointed that we have not seen further progress on those proposed changes and in fact understand that due to the volume and variety of feedback received that they seem to have in fact pulled back from likely implementing many of the proposed changes.

We are also disappointed that in the meantime IIROC has released a number of notices and proposals (including the one addressed by this letter) that would serve to stifle some of the reasonable market responses to the problems in our marketplace and without offering any solutions to the issues that we and others have been raising for many years.

We have tried to propose a number of viable solutions in this letter that we think would address the significant problems with our market while addressing some of the valid market quality concerns raised by IIROC. Many of these solutions however would require the proposed changes to the OPR framework to be implemented. We would therefore strongly urge IIROC and the CSA to continue to push forward on these issues and to avoid implementing the type of protectionist regulation found in this proposal.

Responses to Specific Questions

1. *Are there alternative approaches which would ensure that the policy objectives of the Order Exposure Rule and the dark liquidity framework are achieved?*

As discussed, our suggestions would be to:

- Rationalize the minimum tick size
- Allow orders for more shares than available on the CBBO to be traded dark in Canada without price improvement, while eliminating or raising the 50 board lot standard.
- Allow the creation of a visible market with liquidity removal limited to retail orders.
- Provide order protection only to marketplaces which do not use a maker/taker pricing model
- Follow through with a maker/taker fee elimination pilot study.

These are changes which would improve the competitiveness of the Canadian marketplace and address the core market structure issues behind cross border routing rather than erecting a fence to artificially contain order flow at a significant cost to Canadian market participants.

2. *Are U.S. dollar denominated accounts, by their nature, distinct from other client accounts such that they should be permitted to trade in the U.S. without reference to the CBBO? If an exception to UMIR 6.3 existed for U.S. dollar denominated accounts, could the exception be exploited contrary to the principles espoused in the Order Exposure Rule?*

Orders (rather than accounts) denominated in U.S. dollars or specifically directed to the U.S market should be permitted to trade in the U.S. without reference to the CBBO. In general we expect that the industry treats these as orders for the U.S. markets and in practice applying UMIR 6.3 to these orders will primarily lead to them trading on U.S. visible markets. Applying order exposure to them would create a large amount of work for the industry, lead to worse fills for the investor, and not create any benefit for the Canadian market.

This seems to be consistent with IIROC's response that "The Proposed Anti-Avoidance Provision has no effect in circumstances where the client has instructed or chosen the execution jurisdiction." We would expect if the client has sent an order for the U.S. symbol ("ABC US", "ABC.N" etc.) then they have chosen the U.S as an execution jurisdiction.

If the client account is U.S. dollar denominated but the order is received in Canadian dollars or for the Canadian symbol (e.g. "ABC CN") we do not believe an exception is necessary.

In either case, we do not foresee such an exception being abused. Generally clients select the market they wish to execute in based on a variety of factors, such as price, liquidity, settlement currency and other factors and we do not expect this to sway their decision. If desired, language could be introduced to ban exploitation of the exception.

3. *Does the proposed implementation date of 90 days following the publication of the notice of approval of the Proposed Amendments provide sufficient time to accommodate any development work that may be required to be performed by Participants?*

As long as our understanding of question 2 is correct, we do not see an issue. If the intent is that USD denominated orders on interlisted symbols, or those specifically directed to the U.S market, be subject to this provision then 90 days is likely not enough time for retail brokers to introduce special order handling techniques for these orders.

Conclusion

We were very optimistic last year when the CSA introduced proposed changes to the OPR framework. These would have addressed many of the issues we see with our market. We have been disappointed by the lack or further developments on those proposals and are concerned that they have stalled in the regulatory process. In the meantime rule changes such as those in this notice have been proposed that would make the current difficult situation worse for many market participants.

We strongly urge IIROC to resist implementing the protectionist measures contemplated in this proposal and instead focus on the core issues facing our market. These are important matters for the long term competitiveness of our market and hiding ourselves behind artificial trade barriers will do nothing to improve our ability to compete for global order flow.

As always we appreciate the opportunity to comment on this proposal and would be pleased to answer any further questions that you may have or provide any clarifications on what we have proposed here.

Sincerely,

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