CANADIAN SECURITY TRADERS ASSOCIATION, INC.
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November 13th, 2014

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
100 F. Street, N.E.
Washington, DC 20549

via email

Re: Canadian Securities Administrators Initiative to Study Marketplace Rebates

Dear Chair White:

We would like to bring to your attention the opportunity to conduct a comprehensive cross-border study of the effect of marketplace rebates on market quality and integrity, in conjunction with the Canadian Securities Administrators ("CSA"). Such a study is currently contemplated by the CSA. We believe that a cross-border pilot study focused on inter-listed stocks will benefit both regulatory bodies, with our reasons outlined below.

The Canadian Security Traders Association, Inc. 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 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" or "we"), a group of 21 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.

Introduction

In May, 2014, the Canadian Securities Administrators, an umbrella body of Canadian securities regulators, published a holistic review of market structure issues facing Canada and offered a number of regulatory proposals[1]. Among those proposals, the CSA is proposing to conduct a pilot study on the effect of disallowing trading rebates offered by marketplaces. While details of the study are not yet determined, the CSA's proposal contemplates including a significant proportion of Canadian securities, and effectively banning the maker-taker pricing model in those securities for the duration of the pilot.

The CSA's intention to conduct a pilot stems from concerns that maker-taker pricing, the current model of incentivizing liquidity provision by marketplaces, may result in certain distortions which need to be understood and addressed. Simultaneously, there is a concern that prohibiting the payment of rebates outright could have a negative effect on liquidity. The difficulty in accurately forecasting the impact of fundamental changes to liquidity incentives leads the CSA to propose a controlled pilot study, the results of which would help guide future policy decisions.

The universe of cross-listed equities is significant. Over 200 Canadian listed securities are also listed on a U.S. exchange (generally referred to as "inter-listed" stocks). Unlike ADRs, inter-listed stocks are fully fungible securities that seamlessly clear cross-border due to the close integration of the two clearinghouses (CDS and DTC). Activity in inter-listed stocks also represents a very significant portion of overall Canadian market activity. The list includes the majority of the constituents of the Canadian large-cap benchmark index, the S&P/TSX 60 Index, of which 46 members are inter-listed. These equities are very relevant to Canadian equity markets, and any change to the rules of trading around inter-listed stocks will result in behavior changes on the part of the investment community in Canada. We believe that inter-listed stocks offer a uniquely attractive population for a pilot study dealing with marketplace rebates.

Industry feedback[2] on the CSA's proposed rebate pilot highlights the structural risks to changing the practice of payment of marketplace rebates without corresponding changes in the U.S. market. Many respondents to the CSA's proposal expressed concerns that without U.S. involvement, a pilot would lead to dramatic differences in trading economics on inter-listed stocks between Canadian and U.S. markets. In turn, this difference would lead to regulatory arbitrage, and detract from the quality of the results of the pilot.

On the other hand, many in the industry question the value of conducting a study that excludes inter-listed securities, since much Canadian activity is concentrated in these stocks. Feedback from industry suggests that the results of a rebate pilot which includes only non-inter-listed

[1] http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20140515_23-101_rfc-pro-amd.pdf
[2] CSTA response available at http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20140919_23-101_csta-trading-issues-committee.pdf

stocks will not be transferrable to the inter-listed universe. This puts into question the value of conducting a pilot in the first place.

Proposal: Cross-border Coordination of the Canadian Rebate Pilot

We believe the CSA's publicly stated desire to conduct a detailed pilot study on the effect of the payment of marketplace rebates presents an opportunity for a unique cross-border initiative which could be beneficial to both jurisdictions.

Specifically, we believe that the universe of Canada-U.S. inter-listed securities may be among the best candidates for a pilot study on the impact of marketplace rebates. We offer our reasoning below:

1. The regulatory regimes of the United States and Canada are broadly similar, which is supportive of a joint pilot study. At the same time, the unique aspects of each market offer an opportunity to study the effects of rebates in the context of notable regulatory differences. Such differences include, but are not limited to, the practice of payment of order flow (banned in Canada), trade-at and marketplace fair access.

2. The U.S. and Canadian markets are closely integrated from an operational standpoint. Trade clearing and settlement is largely seamless, markets share common trading hours, and the investment communities in each country are generally familiar with each other. Technologically, cross-border routing and inter-listed arbitrage is commonplace, leading to a de-facto integrated market for inter-listed securities. This close integration is exemplified by the recent conversation between you and OSC Chair Wetston describing our border as "porous" with respect to capital flows[3].

3. Canadian inter-listed equities are, by virtue of being listed for trading in two jurisdictions, the most fragmented in North America. One of the key concerns associated with maker-taker pricing is that it may contribute to unnecessary additional fragmentation of markets and orders across those markets. By focusing a study on specifically inter-listed securities, the fragmentation of both U.S. and Canadian markets could be reflected simultaneously. Additionally, a control group could be constructed for each marketplace using comparable non-inter-listed stocks to draw individual conclusions for each market.

4. The universe of inter-listed stocks captures a wide variety of characteristics in terms of price tiers, liquidity levels and fundamental volatility. We believe that having such breadth available for the sample would be critical to ensuring that a pilot study produces meaningful conclusions.

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[3] OSC Dialogue 2014, October 16th 2014, in conversation between SEC Chair Mary Jo White and OSC Chair Howard Wetston.

5. Focusing on inter-listed stocks would minimize the impact on U.S. Tier 1 Equities. Inter-listed securities are generally not part of critical U.S. domestic benchmarks and therefore are classified as Tier 2 Equities. We believe the selection of inter-listed securities would therefore be a prudent way for U.S. regulators to minimize the impact of a pilot of the core U.S. domestic securities in the Tier 1 universe.

6. The CSA has already stated an interest in engaging in a pilot study of maker-taker. With implicit support for such a study from Canada's regulatory bodies, there is a meaningful opportunity for cross-jurisdictional co-operation with U.S. regulators. Both jurisdictions have publicly expressed a desire to be data-driven in policy making. Engaging in such a pilot in co-operation will demonstrate a commitment to this principle while offering opportunities to share the administrative and analytical burden associated with such a study.

7. The Investment Industry Regulatory Organization of Canada, the Canadian equity markets' self-regulatory organization, is well positioned to offer unique insight into the role that various participants play in the price formation process. With private data accessible through its STEP System (analogous to that planned to be made available via the planned Consolidated Tape), we suggest that Canada could be a valuable partner in shedding light on the role that different groups of traders play in the price formation process – something that may be particularly valuable in the context of a pilot study.

8. Additionally, a joint market structure initiative of this nature would reinforce global coordination in capital markets initiatives.

We strongly believe a joint SEC-CSA cross border rebate study focused on Canada-U.S. inter-listed equities would be mutually beneficial to regulators on both sides of the border, while accomplishing results that would be more difficult to replicate independently.

In light of the above, we ask that the SEC partner with the Canadian Securities Administrators in designing and administering the proposed marketplace rebate pilot study.

We appreciate the opportunity to comment on this matter.

Respectfully,

"Signed by the CSTA Trading Issues Committee"

c.c. to:

Securities and Exchange Commission:
Mr. Luis Aguilar, Commissioner
Mr. Daniel Gallagher, Commissioner

Mr. Michael Piwowar, Commissioner
Ms. Kara Stein, Commissioner
Mr. Steven Luparello, Director, Division of Trading and Markets

Security Traders Association:
Mr. John Daley, Chair
Mr. Rory O'Kane, Vice-Chair
Mr. Jim Toes, President & CEO

Ontario Securities Commission:
Mr. Howard Wetston, Chair and CEO
Ms. Maureen Jensen, Executive Director & CAO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

British Columbia Securities Commission:
Ms. Sandra Jakab, Director, Capital Markets Regulation

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

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Ms. Andrew Kriegler, President and CEO
Ms. Wendy Rudd, SVP, Market Regulation and Policy
Ms. Deanna Dobrowsky, Vice President, Market Regulation Policy
Ms. Victoria Pinnington, Vice President, Trading Review & Analysis