

**CSA Notice 23-325**  
*Trading Fee Rebate Pilot Study*

January 23, 2020

**I. INTRODUCTION**

The Canadian Securities Administrators (the **CSA** or **we**) have either approved or not objected to<sup>1</sup> the Trading Fee Rebate Pilot Study that applies temporary pricing restrictions on marketplace transaction fees applicable to trading in certain interlisted and non-interlisted securities (the **Pilot Study**). The implementation of the Pilot Study will be conditional on the implementation of a similar study in the United States (the **SEC Fee Pilot**).<sup>2</sup> In the event the SEC Fee Pilot does not proceed, the CSA will not move forward with the implementation of the Pilot Study.

We are publishing the design of the Pilot Study (the **Final Design Report**) at Appendix A and the form of an order for the implementation of the Pilot Study at Appendix B to this Notice. The Final Design Report will also be available on the websites of other CSA jurisdictions, including:

[www.lautorite.qc.ca](http://www.lautorite.qc.ca)

[www.albertasecurities.com](http://www.albertasecurities.com)

[www.bcsc.bc.ca](http://www.bcsc.bc.ca)

[www.fcnb.ca](http://www.fcnb.ca)

[nssc.novascotia.ca](http://nssc.novascotia.ca)

[www.osc.gov.on.ca](http://www.osc.gov.on.ca)

[www.fcaa.gov.sk.ca](http://www.fcaa.gov.sk.ca)

[www.mbsecurities.ca](http://www.mbsecurities.ca)

The Pilot Study will begin on a date concurrent with the implementation of the SEC Fee Pilot. Once we have confirmation that the SEC Fee Pilot is proceeding, we will publish a notice of implementation that will provide additional details including the start date of the Pilot Study. See Part IV of this Notice for additional information regarding timing and duration.

**II. PURPOSE OF THE PILOT STUDY**

The CSA is concerned that the payment of rebates by marketplaces may be affecting the behaviour of marketplace participants by:

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<sup>1</sup> The Autorité des marchés financiers and the Ontario Securities Commission have approved the Trading Fee Rebate Pilot Study. In addition, the Alberta Securities Commission, the British Columbia Securities Commission, the Financial and Consumer Affairs Authority of Saskatchewan, the Financial and Consumer Services Commission of New Brunswick, the Manitoba Securities Commission, the Nova Scotia Securities Commission, the Office of the Superintendent of Securities, Service Newfoundland and Labrador, the Prince Edward Island Office of the Superintendent of Securities, the Department of Justice of the Government of Nunavut, the Office of the Superintendent of Securities of the Northwest Territories and the Office of the Yukon Superintendent of Securities have not objected to the Trading Fee Rebate Pilot Study.

<sup>2</sup> Published at: <https://www.sec.gov/rules/final/2018/34-84875.pdf>. Please also see the “Notice Establishing the Commencement and Termination Dates of the Pre-Pilot Period of the Transaction Fee Pilot for National Market System Stocks,” published at: <https://www.sec.gov/rules/other/2019/34-85906.pdf>.

1. creating conflicts of interest for dealer routing decisions that may be difficult to manage;
2. contributing to increased segmentation of order flow; and
3. contributing to increased intermediation in actively traded securities.

The purpose of the Pilot Study is to determine the effects of the prohibition of rebate payments by Canadian marketplaces.

### III. THE DEVELOPMENT OF THE PILOT STUDY

The CSA has been considering a pilot study on the payment of trading fee rebates for a number of years as part of our continued work to foster fair and efficient capital markets and confidence in capital markets. On May 15, 2014, we published a Notice and Request for Comment (the **2014 Notice**) that proposed amendments to National Instrument 23-101 *Trading Rules* (**NI 23-101**) in relation to the order protection rule (**OPR**).<sup>3</sup> On April 7, 2016, as a result of our review of OPR, we published a Notice of Approval of Amendments to NI 23-101 and Companion Policy 23-101CP (the **2016 Notice**).<sup>4</sup> In the 2016 Notice, we acknowledged that we had been considering a pilot study to analyse the impact of the payment of trading fee rebates. However, despite stakeholder support, feedback from commenters and academics suggested that there are certain risks to running a pilot study independent of the United States due to the interconnected nature of North American markets and Canadian equity securities that are interlisted in the United States. Therefore, we decided not to move forward with a pilot study unless a similar study was undertaken in the United States.<sup>5</sup>

On March 14, 2018, the United States Securities and Exchange Commission (**SEC**) proposed new Rule 610T of Regulation National Market System (**NMS**) that would conduct a transaction fee pilot for NMS securities,<sup>6</sup> resulting in an opportunity for a Canadian pilot study.

On March 16, 2018, we published CSA Staff Notice 23-322 *Trading Fee Rebate Pilot Study*<sup>7</sup> to provide an update on our plans to study the impacts of transaction fees and rebates on order routing behaviour, execution quality, and market quality, and noted that we have been engaged in dialogue with SEC Staff. In July 2018, we retained three Canadian academics (the **Academics**)<sup>8</sup> to design the Pilot Study and measure the results. Then, on September 12, 2018, the Capital Markets Institute at the Rotman School of Management held an event where the

<sup>3</sup> Published at: (2014) 37 OSCB 4873.

<sup>4</sup> Published at: (2016) 39 OSCB 3237.

<sup>5</sup> Please refer to section 7 *Pilot Study on Prohibition on Payment of Rebates by Marketplaces* in (2016) 39 OSCB 3237.

<sup>6</sup> Published at: <https://www.sec.gov/rules/proposed/2018/34-82873.pdf>

<sup>7</sup> Published at: [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_sn\\_20180316\\_23-322\\_trading-fee-rebate-pilot-study.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20180316_23-322_trading-fee-rebate-pilot-study.htm).

<sup>8</sup> The CSA selected the following group of researchers with expertise in Canadian equity market structure to design and conduct the pilot study: Katya Malinova, Andriy Shkilko, and Andreas Park. The announcement regarding the retaining of the Academics was published at: [http://www.osc.gov.on.ca/en/NewsEvents\\_nr\\_20180801\\_csa-trading-fees-rebates-pilot-study.htm](http://www.osc.gov.on.ca/en/NewsEvents_nr_20180801_csa-trading-fees-rebates-pilot-study.htm).

Academics provided a presentation of their preliminary thoughts on the structure of the Pilot Study, followed by a panel discussion and open forum.

On December 18, 2018, we published CSA Staff Notice and Request for Comment 23-323 *Trading Fee Rebate Pilot Study* (the **2018 RFC**)<sup>9</sup> to obtain feedback on the design, specifications, and implementation of the then proposed pilot. The 2018 RFC was published for a 45-day comment period, which, following stakeholder feedback,<sup>10</sup> was extended to March 1, 2019 by way of CSA Staff Notice 11-340 *Extension of Comment Period*.<sup>11</sup> A list of those who submitted comments and a summary of the comments and our responses are attached at Appendix C to this Notice. Copies of the comment letters are available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca). Notably, a joint letter submitted by nine Canadian pension plans and global asset managers expressed strong support for the Pilot Study. In contrast, all but one marketplace do not support it. However, the majority of stakeholders, including dealers, are in favour of the Pilot Study.

On December 19, 2018, the SEC published new Rule 610T of Regulation NMS to conduct the SEC Fee Pilot. The SEC Fee Pilot allows for coordination with the Pilot Study and we will continue our discussions with SEC Staff to align the two pilot studies.

#### **IV. SUMMARY OF THE PILOT STUDY**

##### **a. Timing and Duration**

The Pilot Study will be implemented on a staggered basis consisting of two stages:

1. interlisted securities in tandem with the implementation of the SEC Fee Pilot, if possible; and
2. non-interlisted securities and exchange-traded products (**ETPs**) three months following the introduction of interlisted securities.

We intend to provide market participants with as much notice as is possible prior to implementation of the first stage of the Pilot Study. However, it is important that the implementation of the Pilot Study be aligned with the timing of the SEC Fee Pilot. Given the uncertainty regarding the SEC Fee Pilot, we note that implementation timing may need to be expedited. Once we have confirmation that the SEC Fee Pilot is proceeding, we intend to issue orders in the form at Appendix B of this Notice for each of the applicable marketplaces, outlined in further detail below. These orders will be accompanied by a public notice that sets out additional details of implementation, including the start date of the Pilot Study.

With respect to the duration of the Pilot Study, we expect that it will conclude in tandem with the SEC Fee Pilot, at which point the fee structures of all marketplaces are expected to revert to

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<sup>9</sup> Published at: [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20181218\\_23-323\\_trading-fee-rebate-pilot-study.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20181218_23-323_trading-fee-rebate-pilot-study.htm).

<sup>10</sup> Please see Comment Letter from Deanna Dobrowsky, Vice President, Regulatory Office of the General Counsel of TMX Group dated January 9, 2019, available at [http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com\\_20190109\\_23-323\\_tmx.PDF](http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20190109_23-323_tmx.PDF).

<sup>11</sup> Published at: [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_sn\\_20190117\\_11-340\\_rebate-pilot-study.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_sn_20190117_11-340_rebate-pilot-study.htm).

those in place prior to the Pilot Study. Marketplaces will then be permitted to file any fee change that accords with Canadian securities laws subject to further regulatory action that may result from the analysis of the Pilot Study.

Throughout the Pilot Study, the Academics will review the market quality metrics identified in the Final Design Report on an ongoing basis. Where these metrics indicate that the Pilot Study is having a significant and extended detrimental impact on market quality, the CSA will respond promptly and the Alberta Securities Commission, British Columbia Securities Commission, and Ontario Securities Commission (together, the **Commissions**) will proceed to issue orders under their respective securities legislation revoking or varying the orders implementing the Pilot Study, effectively ending or varying it.<sup>12</sup>

### **b. Applicable Marketplaces**

The Pilot Study will be applicable to all trading fee rebates paid by Canadian marketplaces, both exchanges and alternative trading systems (**ATSs**), for the execution of orders with respect to certain equity securities and ETPs, outlined in greater detail below. The Pilot Study will apply to all trading fee models, including “maker-taker” and “inverted maker-taker.”

### **c. Pilot Study Securities**

The Pilot Study will consist of two samples:

1. A set of securities selected from a list of highly liquid securities that is prepared and published by the Investment Industry Regulatory Organization of Canada (**IIROC**);<sup>13</sup> and
2. A set of actively traded, medium liquidity securities that has been constructed by the Academics.

These sample securities include both interlisted and non-interlisted common stocks, as well as ETPs, that are listed on the TSX and TSXV. The list of Pilot Study securities will be appended to the orders implementing the Pilot Study.

Half of the sample securities will be assigned to a treatment group for which a prohibition of trading fee rebates will be applied. Each security in the treatment group will be matched with a control security that has similar characteristics, including firm size, share price, and trading volume. Trading fee rebates will continue to be permitted for those securities in the control group.

The selection of ETPs in the sample will follow the approach described in the Final Design Report. ETPs with the same underlying index will be placed together into either the treatment or control group. ETPs in the treatment group will be matched with other ETPs with the same underlying security type (i.e. fixed income, equity, commodities etc.), but a different underlying index.

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<sup>12</sup> In Ontario, the Ontario Securities Commission will issue orders under s. 144 of the *Securities Act* (Ontario), revoking or varying the orders issued under ss. 21(5) and 21.0.1, as applicable.

<sup>13</sup> Please see: <http://www.iiroc.ca/industry/rulebook/Pages/Highly-Liquid-Stocks.aspx>.

#### **d. Pilot Study Design**

The Pilot Study prohibits the payment of trading fee rebates, including linked pricing, by marketplaces with respect to trading in treated securities.<sup>14</sup> The Academics will conduct an empirical analysis based on market quality metrics and compare the treated securities with the control securities. This statistical analysis will investigate the effects of the prohibition of rebates by comparing changes in market quality for the treatment and control group securities.

In the event that the SEC Fee Pilot does not proceed, the CSA considered conducting the Pilot Study with only non-interlisted securities. However, we ultimately determined that we should not do so largely because we were not confident of the extent to which the results of such a pilot study could be extended across all securities for policy-making purposes. In addition, it is questionable whether such a pilot study would result in sufficient data to analyze the impact and justify the technology-related costs that would be incurred by industry.

Please see Appendix A for the Final Design Report. Please also refer to GitHub for ongoing code and data analysis from the Academics as the Pilot Study moves forward.<sup>15</sup>

#### **e. Market Making Programs under the Pilot Study**

We believe that exchange market makers play an important role in enhancing liquidity and ensuring an orderly market. However, to avoid possible distortion of the Pilot Study and interference with the ability to meaningfully analyze data collected, we are of the view that the payment of trading fee rebates by marketplaces with respect to trading in treated securities for all market participants, including exchange market makers, should be prohibited.

While the payment of rebates for treated securities will be prohibited, we will review fee proposals filed by exchanges for other non-rebate incentives offered as part of an exchange market making program and make decisions according to the customary approval process. Although we believe that the prohibition of linked pricing supports the integrity of the Pilot Study in generating useful market quality metrics, we are of the view that an exception to a linked pricing prohibition to permit non-rebate linked pricing to exchange market makers is appropriate. We believe that non-rebate incentives applicable to registered market making activities are less likely to interfere with the objectives of the Pilot Study and may further encourage the participation of market makers and enhance liquidity provision. Similar to the SEC Fee Pilot, these incentives can be offered only to registered market makers and only for their market making activity. As an example, a marketplace could offer its market makers volume-based incentives on a monthly basis. For clarity, the CSA intends to closely align its approach here with that taken by the SEC.<sup>16</sup>

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<sup>14</sup> This will include the prohibition of rebate payments for intentional crosses.

<sup>15</sup> See: <https://github.com/mps-consulting/CSA-feepilot>.

<sup>16</sup> See *supra* note 6 at pp. 77-83.

## V. LOCAL MATTERS – IMPLEMENTATION

Certain jurisdictions are publishing other information required by local securities legislation. In Ontario, the Pilot Study will be implemented by orders of the Commission under ss. 21(5) and 21.0.1 of the *Securities Act* (Ontario), as applicable for each exchange and ATS carrying on business in Ontario. The Alberta and British Columbia Securities Commissions will also issue orders implementing the Pilot Study, as applicable for exchanges recognized in those jurisdictions. In each of these three jurisdictions, the respective orders will provide that where a marketplace pays a trading fee rebate with respect to trading in a security that is included in a treatment group in the Pilot Study, that marketplace shall file a fee amendment that would eliminate the rebate payment for the duration of the Pilot Study.

The Commissions will also order that for the duration of the Pilot Study, where a marketplace seeks any amendment to its Form 21-101 F1 or Form 21-101 F2, including the exhibits thereto, that marketplace will file submissions that satisfy the applicable Commission that any proposed amendments do not negatively impact the objective of the Pilot Study. The form of an order, representative of the orders that will be presented to the Commissions to be signed once implementation is confirmed, is attached at Appendix B.

## VI. APPENDICES

- A. Final Design Report;
- B. Form of an order for the implementation of the Pilot Study; and
- C. List of commenters along with chart summarizing comments and CSA response.

## VII. QUESTIONS

Questions and comments may be referred to:

Kent Bailey Trading Specialist, Market Regulation Ontario Securities Commission <a href="mailto:kbailey@osc.gov.on.ca">kbailey@osc.gov.on.ca</a>	Alex Petro Trading Specialist, Market Regulation Ontario Securities Commission <a href="mailto:apetro@osc.gov.on.ca">apetro@osc.gov.on.ca</a>
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