

## Time to review marketplace-access fees

Wed Jul 8 2009  
Page: FP13  
Section: FP Comment  
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Source: Financial Post

In the last few years we have seen electronic trading platforms, known as alternative trading systems (ATSs), begin to compete with the TMX stock exchange, the primary market in Canadian equity trading. These ATS marketplaces provide increased choice to investors and dealers by offering customized technology for trading strategies, potentially transactional anonymity, liquidity and speed of execution. Since the launch of competing marketplaces, trading volumes in Canada have increased dramatically, reducing the cost of trading for all investors.

Since the start of this new ATS world, the regulatory community has been hard at work designing rules for multiple marketplaces that balance integrity, fairness and investor confidence against the flexibility and open architecture necessary to encourage innovation and market participation. In addressing the challenges of rulemaking in a rapidly expanding market with new trading platforms, practices and technology, Canada has considered the U. S. rulemaking experience with multiple markets and its National Market System.

The Canadian Securities Administrators (CSA) and self-regulatory authorities deserve credit for the progress made so far, particularly on decisions relating to shifting the responsibility for routing orders to ensure best price from dealers to marketplaces and, eventually, a more fulsome "trade through" protection rule for investors. On June 5, the CSA Staff announced that the TMX, starting July 1, 2009, would act as the "information processor" responsible for pulling together data feeds from individual marketplaces in Canada to produce a consolidated tape for market participants.

It has long been thought that electronic marketplaces that compete with stock exchanges would achieve lower trading and data costs, as competing markets offer products and services at the lowest possible cost, benefiting investors and other market participants. Indeed, as ATSs emerged, the TMX introduced across-the-board reductions in trading fees. However, this early promise has not continued; as the market shares of ATSs have increased, TMX and ATS trading fees have since levelled off, while data fees ballooned.

Interestingly, even though trading fees have been lowered, most dealers report an overall increase in exchange and ATS trading fees since the multiple marketplace became a reality. While this may seem counter-intuitive, aggregate trading fees are higher because of an increased proportion of fees paid (fees for taking liquidity or existing bid-offer prices) to fee rebates received (rebates for providing liquidity or

posting bid-offer prices) in the multiple market environment. Further, the stock exchange raised trading fees on the increasing proportion of special orders, such as "iceberg" and "market on close" orders.

This should not be surprising. Dealers' decisions are dictated to a substantial degree by regulatory requirements. As a result, they do not have complete discretion to direct their trading to platforms that provide the lowest-priced execution and data services. The dealers' best-price obligation requires them to purchase transactional information from all marketplaces and to direct trading orders to the stock exchange or ATS marketplace with the best price to provide "trade through" protection to their clients, whatever the cost to the dealer. Even if an ATS has a relatively low volume of trades, as long as it is a "protected marketplace" under the rules, a dealer must pay ongoing access and execution fees to it to ensure that the dealer can fill its orders at the best price.

As a result, ATSs have considerable scope to impose whatever trading charges and data fees the regulated market will bear. In fact, recent months have seen a significant escalation in execution fees for penny stocks at several ATSs. It may be only a matter of time before ATSs increase their data fees, as well. Dealers will have no choice but to pay, and competitive pressures in secondary markets will force them to absorb most of these fees rather than pass them on to their clients.

The resulting squeeze on margins will be particularly acute for small dealers as was shown by the recent escalation in trading fees for penny stocks, which, before they were rolled back, put significant cost pressures on regional dealers and pushed some close to the brink. Rising execution and data costs may also threaten the viability of small regional firms. In addition, these charges may impede new firms from entering institutional and retail equity markets.

This potential market impact would be an unintended consequence of dealers' trade-through and best-price regulatory obligations. An escalation in trading and data fees by ATSs could, therefore, require

the regulators to consider fee constraints in the public interest. In the United States, recognizing the implications of unrestrained ATS fees, the Securities and Exchange Commission concluded that the most cost-efficient and transparent approach was to impose limits on access fees for marketplaces.

As indicated in the recent CSA staff notice, the Canadian regulators understand the potential for

excessive trading and market data fees and the potential adverse consequences for dealers and their investing clients. They have recently committed to undertake a review of data fees charged by marketplaces in Canada and globally. CSA staff have also reminded participants that provincial regulators have authority to take action to deal with unjustified or excessive fees, especially if they unreasonably prohibit or limit access to marketplace services. Reliance on regulatory discretion and the absence of a formal rule, however, breed investor and industry uncertainty.

The Canadian securities industry encourages the regulators to conduct a transparent, comprehensive and expeditious review of both trading and data fees, and also of marketplace-access fees. If the review concludes that problems exist in the new multiple market environment, regulators should consider imposing defined "caps" on marketplace access and trading-execution fees and adopting means to ensure that fees for market data are not excessive.

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