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May 21, 2020

Market Regulation Branch
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and

Paul Romain
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Via Email

Re: Lynx ATS Notice of Proposed Changes and Request for Comment

Scotia Capital Inc. appreciates the opportunity to comment on the proposal by Omega Securities Inc. ("OSI") to alter the structure of Lynx ATS by:

1. Introducing broker preferencing
2. Amending hidden trading functionality
3. Creating a "latency-sensitive" trader ID definition and limit latency-sensitive trader IDs to Post Only.

Collectively, these changes significantly change the model behind Lynx ATS. We will address these features in turn.

Broker Preferencing

We do not object to the introduction of broker preferencing to Lynx ATS, as this practice is common and accepted elsewhere in Canada. However, we do not support OSI's proposal to support broker preferencing for anonymous orders.

Broker preferencing is intended to provide a mechanism by which dealers can encourage interaction among their various sources of flow. The queue-jump in lit markets generally comes

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with a trade-off: to benefit from broker priority, dealers provide pre-trade attribution to the market.

The practice of anonymous broker preferencing does not preserve the trade-off of gaining priority in exchange for giving up the dealer's identity. Instead, it introduces the risk of information leakage – as the dealer identity of anonymous orders may be inadvertently released by observing that these orders jumped the queue through broker priority.

We do not believe that anonymous broker preferencing is an appropriate marketplace feature, and believe it should be curtailed at all markets – including in the proposed Lynx 2.0.

Hidden Trading Functionality

We support the proposed enhancements, as they represent a commonly-accepted feature set and do not introduce material differences from existing practices in Canada.

However, we respectfully suggest that the model should be further amended to allow minimal price improvement (MPI) orders to interact with mid-point orders in situations where the protected NBBO is one trading increment wide. As proposed, MPI orders will not interact with other hidden orders – meaning that trades between willing participants (one MPI, the other midpoint) are not taking place. We do not believe this is an appropriate outcome and suggest this be reconsidered.

Latency-Sensitive Post-Only Amendments

We are deeply concerned with the proposal by OSI to introduce an outright limitation on the types of participants that may access displayed orders on Lynx ATS by restricting liquidity-removal to non-latency-sensitive traders only. This proposal introduces concerns over segmentation and fair access. It also sets a dangerous and in our view unacceptable precedent.

At its core, the proposed feature is a protective measure for low-latency market-makers. It subsidizes their activities by limiting who can interact. It is also a subsidy for the group of participants who have the maximum flexibility of activities; no one is requiring LSTs to do anything as these participants operate as principal by definition. They are not fiduciaries of investor assets, and they maintain the critical option of being able to step away. Simultaneously, we believe this group is the most technologically sophisticated set of participants in the market. It is not clear to us that this community needs a further subsidy.

On the contrary, Institutional investors are not afforded this level of protection anywhere in the market. No retail or institutional investor has the luxury of choosing to only trade when they aren't adversely selected. To wit, there are no counterparty selection features given to traditional investors on any marketplace resembling Lynx. The participants who are fiduciaries to savings and owe a best execution duty to their clients have the fewest tools at their disposal to manage counterparty risk.

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The proposal indirectly raises the question of whether it is appropriate for a marketplace – displayed, protected or otherwise – to be the near-exclusive domain of professional market makers who are under no obligation to contribute to the market, but whose counterparties (natural investors) inevitably have no choice but to trade. This has similarities to the structure of the OTC equity market from a bygone era, and is a regression to the past rather than a step forward.

Order Flow Segmentation

The regulatory structure of Canada's equity markets does not generally permit order flow segmentation; this is the nucleus of "fair access." We acknowledge that some marketplace segmentation features currently exist – primarily for the benefit of retail investors. These features all have the common thread of attempting to provide more liquidity to certain participants, rather than to exclude participants altogether. It is not clear that Lynx ATS's market model would by additive to liquidity in the market, rather than serve to redistribute existing quoting practices onto a market that is not accessible by a subset of participants.

Contrary to this principle, Lynx 2.0 would segment the market into those who can interact, and those who cannot. It would serve to protect latency-sensitive providers of liquidity (with resting orders on Lynx ATS) from adverse selection by their own ilk. This is a double standard. On the one hand, Lynx ATS seeks to attract liquidity provision by LSTs. On the other hand, it bars those same LSTs from accessing quotes which may be provided by anyone – LST or otherwise. By segmenting the market in this fashion, one drives a clear wedge between providers and demanders of liquidity through the very definition of "LST".

The segmentation approach is also inconsistent within the Lynx 2.0 model. Latency-sensitive providers of resting orders to Lynx are effectively choosing to only interact with non-latency-sensitive participants. On the other hand, the non-LST participants and firms do not have a similar ability to filter out undesired counterparties. We find this dichotomy unreasonable; why is only one side afforded protection? Particularly, why is the protection afforded to the most technologically-advanced participants without offering tools to the demanders of liquidity who owe a duty to their clients?

We object to the practice of order flow segmentation on the basis of our view that it will ultimately harm investors. We believe the Lynx 2.0 model will only benefit situations where orders can be completed in their entirety on Lynx alone, to the detriment of the broader market and in particular institutional investors and their dealers.

Fair Access

National Instrument 21-101 states that a marketplace "*must not unreasonably prohibit, condition or limit access by a person or company to services offered by it.*" OSI clearly seeks to prohibit and limit access to latency-sensitive participants by preventing LSTs from accessing resting orders on Lynx. We believe this is unreasonable, and should be disallowed.

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OSI's argument in favour hinges on Lynx ATS's current status as an unprotected market. In effect, OSI wishes for Lynx to be unprotected despite any commercial success it may achieve, as the filing clearly states that if market share were to grow to meet the CSA's threshold for protection, OSI would seek to introduce a de-minimis speed bump (which would automatically make it unprotected).

We find OSI's stance inconsistent. OSI wishes to amend the Lynx model with the implicit goal of achieving greater marketplace penetration. Simultaneously, OSI admits that the model would need to change to include a speed bump (rather than an outright access ban) if Lynx were to grow to the point of becoming a protected marketplace. These are not congruent goals; either the model brings long-term success (and can remain as-is), or it does not. The regulations governing marketplace operations are applied uniformly, and there is no separate set of rules for "low market share" marketplaces other than the threshold for order protection – which applies equally to all lit marketplaces operating today.

We therefore believe that the assessment of the proposal should be taken from the perspective of what is permitted in general, and which limitations are reasonable, without regard for whether a particular feature set is acceptable only in the context of unprotected marketplaces.

We acknowledge that this is a difficult conundrum to resolve given that speed bump markets are also automatically unprotected, regardless of their market share, and that speed bumps are a limitation on access. However, speed bump markets do not entirely prohibit access; they make it more difficult. The Lynx proposal turns the difficulty into an impossibility for a subset of participants, which is a significantly higher bar in our view.

Precedents: Past and Future

We disagree with OSI's contention that this proposal is consistent with existing practices, for the following reasons:

- Alpha's IntraSpread model (restricting liquidity-removal to retail IDs) has been decommissioned since 2014. Changes to equities trading dynamics in the intervening six years have been significant. We do not believe it is appropriate to rely on the precedent of a (controversial) dark trading facility, which is no longer in operation, as a basis for the approval of access restrictions to a displayed market operating today.
- Liquidnet restricts access on the basis of the type of counterparty – dealer vs. buy-side. The premise of the model is around the interaction of investors' orders without the direct involvement of executing dealers. The Liquidnet model contains a range of features which are not comparable with the Lynx ATS model of a lit marketplace, and restrictions on access at Liquidnet cannot be used as a precedent unless it is to a model that replicates substantial parts of Liquidnet's market model – which Lynx does not do.

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On the other hand, the Lynx 2.0 proposal is fundamentally consistent with the original proposal for a marketplace by Aequitas Innovations, where orders market "SME" were to be prohibited from accessing quotations[1]. This proposal raised significant concerns from industry and was ultimately withdrawn in favour of the speed bump approach currently in place in NEO Exchange Inc's NEO-N book. The analysis which applied to the Aequitas "hybrid" book applies equally to Lynx 2.0.

We also assume that if the limitations on access in the Lynx 2.0 proposal are approved, similar limitations could become adopted by other marketplaces as the precedent is set. However, the specific conditions may be different from venue to venue. Since each marketplace operator would control their own policies and handle their own certification of whether a given participant is worthy of access, access to the collection of markets would become a function of each individual user rather than a baseline ability independent of trading style. The NBBO in the market becomes the NBBO of the user, as certain unprotected markets are no longer simply "optional" – they are prohibited.

Such an environment is the antithesis of transparency. There is no ability to know a priori whether a displayed quotation is accessible by a given user without simultaneously considering the range of access restrictions which may be at play. How would one then ensure that best execution is being provided to clients? How would one decide how to rest client orders when the ability of a displayed order to be filled depends on the access conditions imposed on others?

We believe the precedent-setting nature of Lynx 2.0 is a bridge too far for Canadian markets. The proposal is a repudiation of fair access principles, and in our view should be denied.

We appreciate the opportunity to comment on this important matter.

Respectfully,

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[1] https://www.osc.gov.on.ca/documents/en/Marketplaces/xxr-aequitas_20130813_rfc-pro-structure.pdf