

13.2.2 Nasdaq CXC Limited – Introduction of the CX2 GEF Facility – Notice of Approval

NASDAQ CXC LIMITED

NOTICE OF APPROVAL

INTRODUCTION OF CX2 GEF FACILITY

In accordance with the requirements set out in the *Process for the Review and Approval of Rules and the Information Contained in Form 21-101F1 and the Exhibits Thereto* (Exchange Protocol), on December 20, 2018, the Commission approved significant changes to Form 21-101F1 for Nasdaq CXC Limited (Nasdaq Canada) reflecting the introduction of the CX2 GEF Facility (GEF Facility).

Nasdaq Canada's Notice and Request for Comment on the proposed GEF Facility was published on the Commission's website and in the Commission's Bulletin on October 26, 2017 at (2017) 40 OSCB 8793. Four comment letters were received. A summary of the comments received and Nasdaq Canada's responses can be found at <http://www.osc.gov.on.ca/en/56623.htm>.

The GEF Facility is expected to become effective in the second quarter of 2019.

SUMMARY OF COMMENTS AND RESPONSES

Note: *The responses to the comments reflect the views of Nasdaq Canada and do not necessarily reflect the views of the Ontario Securities Commission (OSC).*

The following is a summary of comments received in response to Nasdaq CXC Limited's (Nasdaq Canada or we) Notice and Request for Comment regarding the proposed introduction of the Guaranteed Execution Facility (Notice) published on October 25, 2017. Four comment letters were received in response to the Notice from the following market participants:

1. Aequitas NEO Exchange
2. Canadian Securities Trading Association, Inc.
3. ITG Canada Corp.
4. Scotiabank

Please note that after further consultation with clients and in consideration of the comments received, we have made the following changes to the Guaranteed Execution Facility (GEF) Member obligations:

- Only trading activity (orders and trades) by the Approved Trader for each GEF Member assigned responsibility to meet the obligations of the GEF Member will be credited to the GEF Member when assessing the performance of the GEF Member;
- GEF Member quoting and trading obligations will be met only with quoting and trading activity on Assigned Securities on the CX2 Trading Book and not across other Nasdaq Canada Trading Books; and
- We have replaced the TCV trading obligation with the following quoting obligations that must be met by GEF Members to ensure they continue to serve as GEF Members for Assigned Securities:
 - Providing a quote of at least 2 Board Lots on each side of the market 95% of the time within 5% of the last sale price; and
 - Providing a quote at the NBB and NBO at least 20% of the time.

GENERAL COMMENT	NASDAQ CANADA RESPONSE
Several commentators expressed concerns with the overall purpose of guaranteed fill facilities and that a comprehensive review of all existing market making facilities and client order flow segmentation should be performed to evaluate the impact of these facilities on Canadian market structure.	<p>Concerns expressed by commenters about marketplace guaranteed execution facilities were not raised specifically in response to the Proposed GEF Facility.</p> <p>Although Nasdaq Canada appreciates certain issues raised by commenters particularly regarding concerns over order flow segmentation,¹ the introduction of the GEF Facility is intended to remove the competitive disadvantage with other similar exchange programs that have already been approved and are operating in the market.</p>
SPECIFIC COMMENTS	
<p>Impact to Price and Size Discovery of the GEF Program</p> <p>Two commenters questioned what benefit the GEF obligations will have on promoting price and size discovery.</p>	<p>The GEF Facility is intended to provide several benefits to retail oriented exchange Members while imposing meaningful obligations on GEF Members that will result in enhanced price and size discovery benefiting all participants. The GEF Facility is designed to facilitate the needs of retail oriented users whose trading objective primarily focuses on ensuring full execution of orders sent to a single</p>

¹ See Nasdaq Canada (formally Chi-X Canada ATS Limited) comment letter in response to the Ontario Securities Commission Notice and Request for Comment: **Application for Recognition of Aequitas Innovations Inc. and Aequitas New Exchange Inc. as an Exchange** found at the following link: http://osc.gov.on.ca/documents/en/Marketplaces/xr-aequitas_20140627_nrfc-application2.pdf

	<p>venue resulting in a single trade ticket and in turn lowering back office costs. The obligation for GEF Members to commit to providing auto-executions for at least the GMV size (discussed more fully below) provides a basic level of size discovery for active GEF Orders. Furthermore, by permitting more than one GEF Member (up to a maximum of five) to serve as GEF Members for an Assigned Security and rewarding competing GEF Members that commit to larger sized order commitments with larger sized prorated fills, the GEF Facility has been designed to maximize size discovery opportunities for its users.</p> <p>All participants benefit from the obligations that must be met by GEF Members. The GEF Member quoting obligations ensure that greater size is available at different levels of the order book (therefore increasing market depth) including at the NBBO to trade against marketable orders. GEF auto-executions are only available when there is a visible quote on CX2 at the NBB or NBO. Therefore, GEF Members must provide a quote at the NBBO if no quote exists in order for a GEF Order to be eligible to trade in the GEF Facility. Considered together, these obligations and features of the GEF Facility will result in greater size and price discovery improving market quality for all participants.</p>
<p>GEF Member Obligations – Balancing Obligations with Benefits</p> <p>Several commenters expressed the view that the benefits offered to GEF Members are not commensurate with their obligations.</p>	<p>The economic risk incurred by a GEF Member in meeting its commitment to guarantee the execution of the GMV is significant and in our opinion is greater than the risk incurred by market makers providing only a commitment for odd lot orders. In addition, because competition between GEF Members is permitted by the program this economic risk will often increase because in order to compete for its share of an incoming unsolicited order a GEF Member must commit to a larger size or multiple of the GMV.</p> <p>The GEF Facility as an auto-execution facility does not permit GEF Members to fade their commitments when market conditions change on away marketplaces. With traditional market making programs, because market makers are offered discretion how to meet their posting obligations, they are able to remove their quotes (and the benefit to participants) when a single large order is broken down into smaller sized orders which are identified as being sent to multiple marketplaces at a single price level or multiple price levels. The GEF Member must maintain its auto-execution commitment of at least the size of the GMV against all GEF Eligible Orders.</p> <p>GEF Members are also exposed and must manage the risk of meeting the quoting obligations required to continue to serve as GEF Members. Providing at least a quote on one side of the NBBO for 20% of primary trading hours not only exposes these orders to execution risk on a stand-alone basis but also compounds the economic risk of their GMV commitments on the same side of the market which they cannot opt out of throughout the trading day. The required two board lot commitment on each side of the market for 95% of the time within 5% of the last sale price creates exposure particularly in fast moving markets. We also note that unlike other exchange programs, GEF Members are afforded no advantages with regard to execution priority. Their trading obligation must be met by competing with all other participants.</p> <p>The benefit offered to GEF Members cited by commenters is that GEF Members are able to interact with the market's smallest and most uninformed flow. Although we agree that interacting with this</p>

	<p>type of flow typically is often desirable for market makers, it is important to note that the ability to interact with this type flow is limited to when all other visible orders have been displaced on the CX2 Trading Book. The typical benefit of interacting with this order flow when making a two sided market is generally forfeited by the GEF commitment as it is more often the case that a GEF Member will be immediately offside a GEF auto-execution after the NBBO has moved to another price level. Understanding the sequence of order execution on CX2 for GEF Orders is important when assessing the extent of this lauded benefit. Interacting with this flow at an NBBO price that is collapsing is not unlike the challenges raised by interacting against an institutional order that sweeps the NBBO before moving down a price level.</p> <p>In summary, we believe that obligations imposed on GEF Members in aggregate not only are commensurate with any benefits that are offered but also will result in contributions to price and size discovery in the market that can be enjoyed by all participants.</p>
<p>GEF Member Eligibility</p> <p>One commenter asked for confirmation that GEF Members must be IIROC Dealer Members and that the individuals involved in the use of the GEF Facility must be Approved Persons.</p>	<p>We confirm that only IIROC Dealer Members are eligible to become GEF Members and that Approved Persons are only permitted to fulfill the responsibilities of GEF Members. The commenter will note that the criteria for Membership set out in Section 3.1 – Membership of the Nasdaq Canada Trading Rules and Polices includes the requirement that an applicant is required to be an IIROC Dealer Member in good standing and registered as an investment dealer in all Canadian jurisdictions in which they do business.</p>
<p>GMV – Informational Asymmetry</p> <p>A commenter noted that the ability for GEF Members to be able to dynamically change the size of their GEF Member Committed Volume (but cannot be set below the size of the GMV) will create informational asymmetry.</p>	<p>We refer the commenter to the Notice which describes that in the circumstance where a GEF Member changes the size of its GEF Member Committed Volume that “information about each GEF Member’s Committed Volume is not made public and is only known buy the Exchange Systems.” Since no other participant (including any other competing GEF Member) is made aware of the GEF Members’ CV at any time in the trading day, there is no resulting information asymmetry as all participants have access to the same information.</p>
<p>GEF Member Obligations – Trading Activity on Books other than CX2</p> <p>One commenter raised the concern that trading on other Nasdaq Canada Trading Books should not count towards a GEF Member’s meeting its obligations.</p>	<p>The GEF Member obligations have been clarified so that only quoting and trading activity on the CX2 Trading Book will be considered when assessing whether or not the GEF Member meets its obligations.</p>
<p>GEF Member Obligations – Advantages for Large Dealers</p> <p>Two commenters noted that if other non-market making related flow from a GEF Member is counted in the GEF Member’s trading obligation that this places smaller dealers at a disadvantage.</p>	<p>We believe that the amended GEF Member obligations that now require only quoting obligations to be met are achievable by both large and smaller sized dealers and therefore that no disadvantage exists.</p>