

## Chapter 13

# SROs, Marketplaces, Clearing Agencies and Trade Repositories

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### 13.2 Marketplaces

#### 13.2.1 Aequitas NEO Exchange Inc. – Amendments to Trading Policies – Notice of Approval

##### AEQUITAS NEO EXCHANGE INC.

##### AMENDMENTS TO TRADING POLICIES

##### NOTICE OF APPROVAL

In accordance with the *Process for the Review and Approval of Rules and the Information Contained in Form 21-101F1 and the Exhibits Thereto*, Aequitas NEO Exchange Inc. (“NEO Exchange”) has adopted and the Ontario Securities Commission (the “OSC”) has approved amendments to the NEO Exchange trading policies (the “Trading Policies Amendments”). The Trading Policies Amendments were published for comment on March 29, 2018. NEO Exchange received one comment letter, the summary of which is attached to this notice as Appendix A.

The Trading Policies Amendments, with one change from the proposed amendments as described below, were approved by the OSC on July 3, 2018. The Public Interest Rules relating to the implementation of the matching priority changes and the launch of NEO-D will become effective in late September, 2018, following at least thirty days’ prior notice.

##### **Summary of Changes**

##### **Changes to matching priorities**

Resting orders from NEO Trader™ accounts will trade before resting orders from Latency Sensitive Trader (LST) accounts at the same price for all trading books. Priority of NEO Trader™ orders has also been further reinforced with respect to Designated Market Makers. Amendments to the Trading Policies are as follows:

- Changes to the continuous trading session priorities for each of the Trading Books in Sections 6.07(2), 7.04 (4) and 8.04(3).
- Deletion of the definition of “Market Maker Commitment”, and removal of the concept throughout (Sections 6.07, 8.04, 8.06 and 10.03).

##### **Implementation of a dark book (NEO-D)**

The key features of NEO-D are: (i) all trading will occur at the midpoint; (ii) all orders will be immediately executable upon entry (subject to order constraints); (iii) all participants will be able to enter passive orders and liquidity taking orders (this has been changed from the original proposal in which the latter were to be restricted to orders from NEO Trader™ accounts); (iv) there are no DMM benefits (or obligations). Amendments to the Trading Policies are as follows:

- Changes in Section 1.01 to the definition of “Closing Price” to include NEO-D.
- Deletion of the National Best/Pegged Order functional attributes from Section 5.07(3) and the reference to such orders in Section 8.06.
- Amendments to the description of Contra Election in Section 7.02 and its application in Section 7.03 (for revisions to remove restriction on LSTs, please see Appendix B, below).
- Deletion of descriptions of Mid-Point Call and Size-Up Call and the references to these call auctions throughout Part VII.

APPENDIX A

SUMMARY OF COMMENTS

The following is a summary of comments received in response to the Notice of Proposed Changes and Request for Comment (the Notice) filed by NEO Exchange and published on March 29, 2018, along with NEO Exchange’s responses to these comments.

<i>Comment</i>	<i>NEO response</i>
<p><b>1. NEO Trader and Latency Sensitive Traders (LST) are loosely defined, subjective, and allows Aequitas NEO Exchange to select winners and losers in matching priority.</b></p> <p>Since inception, Aequitas NEO Exchange has facilitated segmentation through NEO Trader and LST Trader classifications. Classification as a NEO Trader or LST Trader critically impacts matching priority and has evolved with limited transparency and regulatory oversight.</p> <p>For example, when a new Trader ID is added, classification for NEO Trader and LST Trader is based on the Aequitas NEO Exchange market participant’s classification. This leads to several questions on the classification process:</p> <ul style="list-style-type: none"> <li>(a) How does the Aequitas NEO Exchange market participant determine the classification? How was the classification qualified by NEO Exchange? The rules and criteria for this determination are not public or transparent.</li> <li>(b) How does Aequitas NEO Exchange monitor the classification? What criteria is used?</li> <li>(c) How frequently are NEO Traders and LST Traders reclassified by Aequitas NEO Exchange?</li> <li>(d) If a NEO Trader or LST Trader is incorrectly classified, is their trading activity unfairly advantaged or disadvantaged during the incorrect classification period?</li> </ul>	<p>Section 1.01 – Definitions of the NEO Exchange trading policies (“Trading Policies”) contains a definition of what constitutes an LST (and a NEO Trader account is defined as anything that is not LST). There is little subjectivity by the Exchange as the Members are responsible for classifying Trader IDs correctly and there is commentary following the definition to assist them in making the determination. As an ongoing validation mechanism, NEO monitors trading activity and looks at order-to-trade ratios and regulatory markers, etc., in accordance with our operational policies and procedures (which we have provided to our regulators) to ensure compliance with the requirements. We also undertake regular reviews of all Trader IDs. All of this is done to ensure that accounts are, in fact, classified correctly.</p> <p>The above processes are described in the NEO Trading Policies and trading functionality guide, which are both available on our website. Further, NEO provides regular reporting to the OSC and staff have reviewed our policies and procedures. We therefore disagree with the statements made by the commenter, as they are based on incorrect assumptions.</p>
<p><b>2. Without greater regulatory oversight and transparency on Aequitas NEO Exchange’s NEO Trader and LST Trader classification process, prioritizing NEO Trader orders over Designated Market Makers (DMM) orders will further contribute to segmentation and internalization.</b></p>	<p>The distinction between NEO Trader and LST is core to our market structure and was discussed at length at the time of our recognition order – and, as mentioned above, is a transparent distinction that is regularly validated through a process that is, in fact, monitored as part of their oversight by OSC staff. Nothing in the current proposal seeks changes to these concepts.</p> <p>We cannot understand the commenter’s link between giving NEO Trader orders priority over DMMs’ orders and further contribution to segmentation and internalization. This proposed change only impacts the market maker who will see their priority reduced. The ultimate beneficiary of this change is the client as the level of intermediation will go down. In no circumstance would this proposed change have any bearing on a dealer’s ability to “internalize” flow.</p>

<i>Comment</i>	<i>NEO response</i>
<p><b>3. The proposed Contra Election in NEO Exchange’s separate dark book (NEO-D), is in violation of the principles of fair access and will result in further segmentation.</b></p>	<p>Along the same lines as the previous response, we feel the commenter is referring to “further segmentation” without explaining how they come to their conclusions.</p> <p>That said, there are numerous examples of segmentation across markets globally, some widely accepted as positive. Canadian examples include Liquidnet, whose model is based on facilitating buy-side to buy-side trading to facilitate large transactions without information leakage.</p> <p>The objective of NEO-D is to create a dark book for natural investors to trade with each other with as little intermediation as possible. It is our view that, while preventing LSTs from taking liquidity could result in increased segmentation, it would lead to an increase in natural investors meeting natural investors, which would not be a novel or negative outcome. However, based on a number of informal comments received, suggesting that any such distinctions may set a precedent that could open the door for problematic forms of segmentation, we have decided to launch NEO-D without any restrictions on LSTs. We will be monitoring LST activity in NEO-D to determine if there is an impact on natural investor participation and/or intermediation and if so may refile for this functionality at a later point in time.</p> <p>In regards to fair access we disagree in principle that the proposed functionality would be in violation of that rule. As has been often said, fair access does not in all cases mean equal access. NEO-D would be an unprotected dark market, and preventing someone from accessing a dark market where there is no pre-trade information about available orders and, as such, no expectation of a fill, does not constitute unfair access. As noted above, though, we have decided to proceed for now without restricting LSTs’ ability to take liquidity.</p>

APPENDIX B

TEXT OF CHANGES TO PUBLISHED PUBLIC INTEREST AMENDMENTS TO THE TRADING POLICIES

7.03 Posting Liquidity Providing Orders in NEO-D

- (1) Liquidity Providing Orders posted in NEO-D may originate from any type of account ~~but~~ and all Liquidity Providing Orders may include the Contra Election designation ~~is not available for orders from LST account, which will be restricted to interacting with Liquidity Taking Orders.~~

7.04 Continuous Trading Session in NEO-D

- (1) In NEO-D, ~~only Liquidity Taking Orders originating~~ subject to the Contra Election, orders from NEO Trader™ ~~all~~ accounts may interact with ~~resting Liquidity Providing Orders. Liquidity Taking Orders from LST accounts will be rejected~~ each other.