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GLOBAL BANKING AND MARKETS

Scotiabank

June 26, 2020

Market Regulation Branch
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and

Matt Thompson
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Via Email

Re: Nasdaq CXC Limited Notice of Proposed Changes and Request For Comments

Scotia Capital Inc. appreciates the opportunity to comment on the proposal by Nasdaq Canada to introduce exemptions to the minimum-size provisions of Mid Peg orders on the Nasdaq CXD market.

General Remarks

We believe this proposal strikes at the heart of the recent consultation on internalization of order flow in the Canadian market. The retail-focused options presented, when combined with broker preferencing and an arbitrarily large size on "minimum quantity" parameters, are an easy path forward for these orders to be used exclusively for retail order flow segmentation and interaction. The "trusted flow" option appears more benign in its name, but similarly offers the ability to interact within one's firm to the detriment of other participants in the market whose orders are unconstrained by minimum size and should therefore have greater standing. The appropriateness of orders of this nature is at the core of the CSA/IIROC consultation, the conclusion of which has yet to be reached.

We believe it would be premature and inappropriate to permit features that take market practices in a particular direction when the appropriateness of that direction is still up for significant debate.

Furthermore, while the Proposal constrains these features only to midpoint orders and only on the CXD marketplace, if approved the precedent will be used to argue for similar features in more damaging contexts. For example, what is to prevent a competing marketplace from imitating the

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approach by offering "retail order" interaction for "minimal price improvement" orders which are otherwise subject to a minimum size constraints? Similarly, dark at-the-touch orders could be structured similarly, offering a path to retail-only interaction for low-priced stocks when active orders exceed the benign requirement of $30,000 in value and 50 board lots of size.

We believe that if the result of the CSA/IIROC consultation is to signal a willingness to allow order flow segmentation and encourage internalization (segmented or otherwise), then features to this end should be developed by marketplaces at that time. Until this point, precedent-setting proposals like Nasdaq's, which entrench a still-controversial practice, should be curtailed.

Externalities to the Market

We disagree with Nasdaq's contention that the benefits brought (by the Retail Option) to both sides outweigh the fairness concerns presented. The same could be said for any proposal which brings benefits to its targeted users, but which nonetheless are seen as "unfair." Clearly the parties benefit; if there was no benefit, there would also be no proposal. The question is whether those who are not included in the arrangement are indirectly harmed. That is the essence of fair access.

The issues around of order flow segmentation and retail internalization hinges on the experience of those whose order flow is not being preferentially internalized, or those who wish to internalize but cannot. By providing a narrow benefit to some resting orders, one implicitly robs others of the opportunity. The irony of the proposal is that it puts orders that explicitly wish to limit their trading (by imposing minimum quantities) on the same footing as those orders which would trade with all comers. The former wish to have their information leakage cake and eat the retail flow too. The latter are exposing themselves by providing post-trade information to the market more readily, but are not afforded a relative benefit. Does this seem fair?

Given the concentration of order flow in Canada, additional features which further support internalization practices run the risk of promoting (or entrenching) a bifurcated market: fully integrated dealers trade within their own network, while others are effectively shut out, all in a framework underpinned by fair access. While this may be of benefit to some parties, the question is whether or not this is to the long-term benefit of Canadian capital markets. Can an ecosystem with significant concentration remain diverse and dynamic enough to support all types of participants in a fair and non-discriminatory manner? This balancing act must be maintained, and we are concerned that precedent-setting proposals which undermine this balance will ultimately harm the ecosystem.

Summary

We appreciate that Nasdaq is attempting to differentiate its offering by introducing novel features which – on the surface – may present some benefits to the institutional community. Our concern rests primarily with the implications for the entirety of the market from the approval of features which erode the principles of fair access. Such features rarely exist in isolation; they are imitated,

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adopted and in many cases made more harmful. This is surely not Nasdaq's intention, but will nonetheless be a consequence.

We believe that until the marketplace receives clarity on the overarching topics of order flow internalization and client segmentation, it is inappropriate to introduce features which push the boundary of current practices. For this reason, we are not supportive of Nasdaq's proposal.

We appreciate the opportunity to comment on this important matter.

Respectfully,

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