CANADIAN® SECURITIES EXCHANGE
The Exchange For Entrepreneurs

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Re: **Notice of Proposed Changes and Request for Comment – New matching priority – change in matching priority on securities below $1 and 30,000 shares.**

Dear Sirs/Mesdames:

The Canadian Securities Exchange ("CSE") appreciates the opportunity to comment on the Notice of Proposed Changes and Request for Comment published by the Ontario Securities Commission on January 21, 2021 on behalf of Nasdaq CXC Limited ("Nasdaq Canada").

1. Significant Change

The matching algorithm in use at the continuous auction markets in Canada has been largely untouched since the inclusion of the broker preference element twenty odd years ago. Intended to assist investment dealers to "find the cross" in a public market setting, it is fair to say that many features of the Canadian trading landscape, unique in world terms, derive from the consequences of the inclusion of broker preferencing to the algorithm. Some of the results were intended and many were not. The point here is not to re-visit the decision to permit broker preferencing, but to remind everyone that the proposed change from Nasdaq Canada is a "significant change" and should carry a very high burden of proof before being allowed to proceed: the benefits must be clearly stated and supported, and an analysis of potential harm, and possible harm reduction measures be included in the supporting submission. As with broker preferencing, it is likely that if Nasdaq Canada is permitted to implement this change, regardless of the public interest considerations, the rest of the marketplaces may have no choice other than to implement similar matching logic. For the reasons we put forward below, we are of the view that Nasdaq Canada has not met that burden.

2. Rationale

Any proposed significant change should begin with a clear definition of the problem being addressed. In this way, if implemented, regulators and other market participants can measure the effectiveness of the change at some future date against the stated goals. There should be a careful analysis of the intended consequences of the proposal, along with measures identified to reduce the risk of potential harm. Nasdaq Canada's proposal does not identify a problem: the proposal merely expresses a view that affording matching priority to orders of 30,000 shares or more for stocks priced below $1.00 will incent the provision of resting orders in size on the CX2 venue, and on this basis, improve the liquidity profile for these stocks. While certain parties, primarily proprietary trading firms which focus on lower priced stocks, may benefit from the priority advantages, there is no analysis offered as to whether there is a material liquidity problem in the trading of these stocks. In fact, we have seen a dramatic expansion in the trading of these stocks (which are listed principally on the CSE and TSX Venture Exchange) over the last year. The reality is that in stocks where it is advantageous to post a resting order for more than 30,000 shares, it is unlikely that liquidity incentives are required to promote trading in these stocks.

3. *Subjective Definition of Large Order Size*

Why and how has Nasdaq Canada chosen the 30,000-share threshold required for execution priority? No evidence is provided as to why this number is more effective than a higher or lower number of shares. In similar fashion, why is this change proposed for sub $1.00 stocks only? If providing size priority is a meaningful way of unlocking more liquidity, why isn't it proposed for stocks trading above a dollar as well? Considerable study must have gone into the identification of this threshold; why isn't this research cited in the materials presented by Nasdaq Canada in the Request for Comment?

The 30,000-share threshold is also not consistent with the other "large in size" definition currently in use in Canada. The current version of UMIR Section 6.6 was amended a year ago to provide that orders above 50 standard trading units and $30,000 in value may be traded on a dark venue without offering price improvement. The provision was amended to include a value element after a dramatic increase in the use of the MatchNow marketplace to execute trades in low priced stocks at the prevailing best bid/offer without price improvement. The CSE received a significant number of complaints from retail investors, investment dealers and issuer firms about their inability to engage with this trading activity. Given that the former threshold to avoid price improvement for dark execution was 50,000 shares, we can expect a 30,000-share level to produce even more complaints from all segments of the trading community. "Just move your order to another venue" may be a sufficient response to technically sophisticated proprietary trading firms but is simply not an option for most retail clients trading through an investment dealer.

4. *Impact Statement*

For an illustration of the potential impact of the proposal, the 30,000-share threshold would capture a considerable percentage of the CSE's order volume by shares. Although only 11% of posted orders exceed the 30000-share threshold, they account for 70% of the resting order volume on the exchange. Most of these orders are entered through trader IDs that support agency orders from the retail arms of Canada's investment dealers. In other words, it is highly likely that these orders were entered by human beings trading for their own account.

Retail users trading CSE-listed securities complain, with some justification, about the complexity and lack of transparency in Canada's current market structure. Few retail investors have access to quote and trade information from the non-listing marketplaces. As we saw with the MatchNow situation, significant trade volumes occurring in the market at one's limit price, without any ability to participate against the resting volume, generates dissatisfaction with the fairness and accessibility of the market. As indicated, the CSE received an enormous number of complaints from retail investors, investment dealers and issuers trying to figure out what was happening. This lack of transparency continues to hurt the credibility of Canada's market structure system in the eyes of its key stakeholders. A number of stakeholders over the years, including the TMX Group, have gone so far as to call for a ban on multi-market trading of these lower priced stocks.

5. Protected Market Status

This proposed change to the fundamental time/broker/price priority used in Canada today would be completely novel within the confines of a protected marketplace.

The Nasdaq CX2 book currently enjoys protected market status within the Canadian marketplace, ensuring that the CX2 quotes contribute to the Canadian Best Bid Offer (CBBO), and are trade-through protected.

If Nasdaq Canada were to change the matching priority on the CX2 book to a price-broker-volume-time priority, even if only for symbols under $1, then the CSE submits that it should lose its protected market status. This approach is consistent with other marketplaces in Canada that have been held outside of the sphere of marketplace protection.

6. Fair Access[1]

The CSE submits that the Nasdaq Canada proposal fundamentally changes the competitive tensions resulting from the traditional continuous auction market process. The ability to adjust orders for price and time priority is open to traders of all kinds. In the matching algorithm proposed by Nasdaq Canada, the retail investor's ability to compete on size is limited:

- they have limited or no ability to route and modify their orders on a particular venue, as the routing decisions are made for them by their investment dealers.
- proprietary trading firms, with better access to market data services than the typical retail investor, can adjust their orders in response to resting volume on the other venues.

The fact of the matter is that retail investors will not be able to compete because of a lack of access to the venue, and a lack of access to the full suite of data products enjoyed by the professionals in the crowd.

In summary, the CSE is of the view that the proposal would result in disadvantages for retail investors, without contributing the promised liquidity benefits to the market. As a result, the CSE strongly urges the Ontario Securities Commission to not allow the Nasdaq Canada proposal to proceed.

Sincerely,

Richard Carleton
Chief Executive Officer

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[1] "A marketplace must **not unreasonably prohibit, condition or limit access** by a person or company to services offered by it." (emphasis added). S. 5.1(1) National Instrument 21-101 *Marketplace Operation*. https://www.osc.gov.on.ca/documents/en/Securities-Category2/ni_20170201_21-101_unofficial-consolidation-forms-cp.pdf.