

13.2 Marketplaces

13.2.1 CX2 Canada ATS – Notice of Completion of Staff Review - CX2 Initial Operations Report

CX2 CANADA ATS

**NOTICE OF COMPLETION OF STAFF REVIEW OF
CX2 CANADA ATS INITIAL OPERATIONS REPORT**

On November 8, 2012, Chi-X Canada ATS Limited (Chi-X) announced its plans regarding the operation of its second Canadian trading facility CX2 Canada ATS (CX2). The description of the proposed operations of CX2 (Proposed Amendments) was published for comment in accordance with OSC Staff Notice 21-706 – *Marketplaces' Initial Operations and Material Systems Changes*, and pursuant to an order requiring Chi-X to comply with the *Process for the Review and Approval of the Information Contained in Form 21-101F2 and the Exhibits Thereto* (ATS Protocol). Six comment letters were received. A summary of and response to those comments prepared by Chi-X is included at Appendix A to this notice.

Also included in Appendix A is a brief summary of the key changes made to the planned operations of CX2 since publication for comment.

The OSC has approved the Proposed Amendments pursuant to section 8 of the ATS Protocol applicable to Chi-X. Chi-X will publish a notice indicating the intended launch date of CX2, which will not be earlier than 90 days from the publication of this notice.

APPENDIX A

CX2 CANADA ATS

SUMMARY OF COMMENTS AND RESPONSES

The following is a summary of comments received in response to CX2 Canada ATS’s Notice of Initial Operations Report and Request for Feedback published on November 8, 2012. Although Chi-X Canada ATS Limited continues to support the originally proposed market structure for CX2 from a policy perspective, in response to customer feedback and our commitment to customer service, we have made the following changes to the platform:

- Removal of Anonymous Broker Preferencing – only attributed orders will be eligible for broker preferencing.
- Removal of Opt-out Attributed Broker Preferencing – all attributed orders are mandated for broker preferencing. There is no longer the ability for participant’s to opt-out
- Execution Priority of Iceberg orders – hidden portions of iceberg orders will execute before any fully hidden order at the same price. Hidden portions of iceberg orders will also be matched based on price/time priority between other iceberg orders.

ISSUE	COMMENTER AND COMMENT	CX2 RESPONSE
<p>Anonymous broker preferencing</p>	<p>SCOTIA CAPITAL INC. - Broker preferencing for attributed orders is supported as on-exchange internalization to increase efficiency and effectively reduce settlement costs</p> <p>a) Objection to the concept in principle - Other marketplaces match for good reason as the omission of broker preferencing with anonymous orders ensures the confidentiality of the order and the successful execution of the trading strategy</p>	<p>Since beginning operations in 2008, Chi-X Canada ATS (Chi-X) has employed a fully anonymous order book and has been expressing concerns about the mechanic of broker preferencing for the following reasons¹:</p> <ul style="list-style-type: none"> - creating an appearance of a two-tiered market thus threatening investor confidence - negatively impacting quote competition by permitting orders to jump the queue and receive execution ahead of price “setters” - creating an inappropriate incentive for customers to become customers of large preferred dealers therefore hurting the prospects of smaller dealers - removing the incentive for large preferred dealers to invest in technology in order to compete on the quote <p>Although we understand the OSC is currently reviewing this practice as part of an overall study on internalization, it appears that we are still far away from there being a decision regarding whether or not it will be permitted to continue. Consequently, we believe that Chi-X subscribers should no longer have to forfeit using Chi-X technology in order to take advantage of broker preferencing on away markets.</p>

¹ Chi-X Canada response to CSA/IIROC Consultation Paper 23-404 Dark Pools, Dark Orders, and other Developments in Market Structure in Canada http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20100105_23-404_cohent.pdf

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	<p>We feel the loss of preferencing with anonymous orders is a known and reasonable trade-off.</p> <p>b) issues with administration of opting</p>	<p>The fundamental policy issue of broker preferencing being applied to attributed or anonymous orders is the same - both result in participants being able to jump the queue and break intra-market price time priority. We note that broker preferencing is permitted on dark pools where by nature pre-trade attribution is not available.</p> <p>We agree with the comment by Scotia that a trade off currently exists in the market when using an anonymous order – comparing the advantage of minimizing information leakage with the cost of foregoing a potential opportunity to jump the queue. We also believe however that the original proposal to combine broker preferencing with anonymous orders would have provided greater trading options for participants while allowing them to opt-out of broker preferencing in order to prevent information leakage when entering orders anonymously.</p> <p>Several commenters pointed out that there is an appropriate trade off in today’s market structure by weighing the cost of forfeiting broker preferencing in order to gain the advantage of trading anonymously. This trade-off however does not recognize the existing advantage of trading with attribution in the first place, which is unique to Canada. By showing their broker number, large dealers that are active in either some particular stocks or in the whole market can in turn attract more and more market share thus giving them an advantage over other dealers with less market share.</p> <p>This advantage, which forms the base assumption of trading in Canada does not exist in the majority of other markets including Australia, Europe, and Japan.</p> <p>Understanding then the benefit that attribution already provides large dealers; Canada’s current practice actually offers participants the benefit of attribution <i>with</i> the benefit of broker preferencing.</p> <p>As stated, we do not see any policy</p>

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	<p>out of broker preferencing on an order by order basis – Opting out on a trade-by trade basis requires the individual handling the order to appropriately tag it, and various order routers in the trade path to pass on this tag correctly as orders are sprayed to various destination which is a complex and error prone method.</p> <p>OMEGA SECURITIES INC. - Would a trade resulting from broker preferencing between a resting anonymous order and a contra-side lit order versus lit order print on the tape with the broker number and therefore negate the goal of the anonymous trade?</p> <p>TMX GROUP – Broker preferencing is an accepted feature of the Canadian market along with the underlying principle being transparency.</p> <p>TD SECURITIES - We also question the need for broker preferencing on anonymous orders since the two are mutually exclusive.</p> <p>ITG CANADA - We are both surprised and disappointed that CX2 is offering a ramped up version of broker preferencing.</p> <p>CSTA - The effect of an anonymous order “jumping the queue” when interacting with an attributed order would immediately disclose the identity of the anonymous order and result in information leakage;</p> <p>If a trader wishes to give up the</p>	<p>reason to not permit broker preferencing with anonymous orders. However, we are sympathetic to Scotia’s concern about the complexity and risk concerning the administration of opting out of anonymous preferencing. In addition, as a provider of marketplace services we take our customer views seriously. Consequently, we have decided to remove this feature from CX2.</p> <p>The trade print in the example would show the broker number on the attributed side of the trade hence revealing the identity of the anonymous order if it was broker preferenced. The opt-out option was proposed so that in this scenario the anonymous order could avoid being broker preferenced in order to preserve anonymity on a post trade basis as well.</p> <p>We recognize the historical origins of broker preferencing. However, the benefits of this practice cited in the letter are achieved today through new regulation. The order exposure rule now mandates entering small size orders on a marketplace. The prohibition of broker dealer internalizers and the new dark rules protect against deterioration of the price discovery mechanism and also encourage visible liquidity by ensuring lit orders are executed ahead of dark orders at the same price.</p> <p>Please see response to Scotia Capital Inc. above.</p> <p>Please see response to Scotia Capital Inc. above.</p> <p>Please see response to Scotia Capital Inc. above.</p> <p>Please see response to Scotia Capital Inc. above.</p>

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	<p>transparency of attribution, then it is entirely reasonable to also take away some of the benefit of that transparency to the trader at question.</p>	<p>Inc. above.</p>
<p>Technology resources and costs of a new marketplace</p>	<p>SCOTIA CAPITAL INC. - Additional costs (from an additional marketplace), include but are not limited to: a) market data costs b) validation and messaging maintenance costs c) connectivity costs d) additional vendor costs for potential programming changes</p> <p>TD SECURITIES - In the case of CX2 we do not see the risk and cost to the industry as being justified compared to the marginal benefit of adding an option for broker preferencing</p> <p>While we acknowledge that a precedent for sub-penny pricing has already been set.....we recommend a moratorium on new marketplaces to prevent further price fragmentation in the Canadian market.</p>	<p>a) Chi-X Canada was the last marketplace to charge for market data and appreciates that added costs for services offered to participants should be reasonable with regards to fee for service. b) Similar to Chi-X, and unlike several other marketplaces, CX2 will not charge for certification or testing. c) CX2 is facilitating connectivity for existing Chi-X customers through their existing connectivity solutions. d) Although we recognize that a certain level of integration will be required, the potential programming changes that will result for vendors should be minimal as there are no new tags supported by the marketplace. CX2's OE and Market Data specifications are identical to those of Chi-X.</p> <p>See previous response to Scotia Capital Inc. above.</p> <p>It is commonly recognized (also by the commenter) that competition between marketplaces had led to innovation and lowered the overall cost of trading. One of the many reasons for Chi-X Canada to begin operating CX2 is to ensure that competition remains healthy for trading services. Given the Maple Group's takeover of TMX Group, three of the six lit marketplaces that operate in Canada are owned by one entity. In order to ensure that a trend does not develop back toward monopolistic practices, it is important that Chi-X Canada be able to differentiate between pricing and market model with two medallions. As stated in the Notice, CX2 will target a different segment of participants than Chi-X does today.</p>
<p>Sub-penny price increment created by maker/taker fee model</p>	<p>TD SECURITIES - An unintended consequence of the make/take fee model combined with multiple marketplaces is that it undermines the</p>	<p>Order prices that take into consideration fees or rebates are available to all participants and provide the opportunity for benefits to be</p>

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	<p>intent of UMIR 6.1 and creates sub-penny trading increments for a select group of market participants.</p> <p>Marketplace operators have an incentive to create multiple venues to cover a range of sub-penny price increments, each at a different make/take level.</p> <p>These sub-penny price increments are at odds with the spirit of fair access since the price points are only available to a select group of High Frequency Trading (HFT) Firms.</p> <p>The more sub-penny price increments that exist in the market, the easier it becomes to gain execution priority over natural orders for a nominal amount.</p>	<p>sought by all participants.</p> <p>Fees and rebates are one area in which marketplaces compete. Other areas include, but are not limited to, reliability, timely processing and consistency, order types, and overall service. The decision to set a specific traditional make/take fee schedule must weigh the attractiveness of the entire offering to both providers and removers of liquidity. If the right balance is not struck, active orders will not be directed if there are no passive orders to trade against as passive orders will not continue posting markets if there are not enough active orders interacting with the book. Other pricing models (like that used by Chi-X on TSXV securities today) provide takers with a rebate and charge a fee to providers. With this kind of fee schedule participants with higher active ratios become the net beneficiaries.</p> <p>All participants can benefit from posting higher rebates (or lower fees) and executing on venues with lower fees (or higher rebates).</p> <p>Many participants employ market making strategies that look to benefit from the spread in addition to HFT Firms. Dealer proprietary desks, in addition to certain buy side accounts also look to optimize their execution costs (both implicit and explicit) as part of their overall trading strategy.</p> <p>It is assumed in this statement and the example set out in the comment letter that routing decisions are only made with consideration of price alone. Routing to a marketplace is impacted by several factors in addition to price including but not limited to; speed and consistency or trade processing, likelihood of liquidity, fill rates, and the opportunity for price improvement with dark order types.</p>
<p>Protected status of marketplaces</p>	<p>TD SECURITIES - An unintended consequence of OPR is that each marketplace has equal standing in the market regardless of its contribution to</p>	<p>Although every visible order or visible portion of an iceberg order is protected under OPR, the rule does not mandate access to every market.</p>

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	<p>price discovery, liquidity or the costs of accessing this venue.</p>	<p>The policy issue of OPR is outside the purview of CX2 however we understand that the existing full depth of book OPR rule in Canada is consistent as it recognizes the contribution made to price discovery and ensures protection to any visible order entered on a marketplace.</p> <p>We note that all fees including those for access, connectivity, and market data must be approved by the OSC.</p>
<p>Intentional crosses excluding interference</p>	<p>TMX GROUP - Unintended consequence of extending broker preferencing to anonymous orders and also to the undisclosed volume of iceberg orders is the potential for a dramatic increase in the use of the iceberg order type and reduction in displayed volume.</p> <p>We feel it is important that participants are aware that time priority of the visible book may be undermined in CX2.</p>	<p>Consistent with current guidance from IIROC and the OSC, lit orders and lit portions of iceberg orders will execute ahead of hidden portions of iceberg orders that will execute ahead of fully hidden orders. Broker preferencing will not be applied to anonymous orders, hidden orders, or hidden portions of iceberg orders.</p> <p>The implementation where intentional crosses exclude interference is well documented in the Notice and Subscriber Manual.</p>
<p>Dynamic re-pricing</p>	<p>CSTA - Dynamic re-pricing which would re-price a potential locking order to the next inferior trading increment rather than lock an away market, appears good, in theory. However, in practice, this feature can lead to situations where a participant enters orders on both sides of the market prices to lock and relies on the ATS function to peg to a one-increment wide NBBO.</p> <p>When the NBBO changes, the automatic re-pricing feature ensures that the participant establishes time priority on the ATS in the direction of the move, disallowing a participant that is actively contributing to price discovery establishing from the said priority. [Example given]</p> <p>The failure to mark SOR take waves</p>	<p>Chi-X has offered dynamic re-pricing to prevent trade-throughs and locked markets since beginning operations and before regulation mandated trade-through prevention by the marketplace. While other marketplaces were allowing trade-throughs to occur, Chi-X was forfeiting executions in order to help participants comply with their best price obligations.</p> <p>With the introduction of OPR and the DAO marker, several marketplaces decided to use an order router for OPR compliance while defaulting all other orders as DAO.</p> <p>When the NBBO changes, participants can enter DAO orders and establish priority ahead of dynamically re-priced orders. Dynamic re-pricing provides an opportunity in the race for time priority to those participants who do not have the tools and the information to efficiently send DAO orders in the direction of the move.</p> <p>A participant, when routing through</p>

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	<p>with the Bypass Marker can (and frequently does) give rise to locked markets.</p>	<p>multiple price levels across multiple markets, must decide whether the trade is price or time sensitive. A participant must choose between obtaining the best price possible by sourcing potential dark liquidity or by using bypass markers that will trade over several price levels at once bypassing hidden orders and hidden portions of iceberg orders. OPR recognizes that the use of bypass may lead to locked or crossed markets and notes this in the Notice of Amendments to NI 21-101 and NI 23-101 published in 2009.² The Notice makes it clear that participants are empowered with choice how to route orders given both of these options.</p> <p>Unlike the position of the commenter, it is possible to gain execution priority on CX2 at a new price level ahead of an order that has been dynamically re-priced. In order to do so, a SOR needs to send bypass IOC orders at all price levels with the exception of the last price. On the last wave, the SOR must send bypass IOC orders to away marketplaces combined with a Day DAO order sent to CX2. In this way the day order will obtain time priority at the newly established price ahead of other re-priced orders.</p> <p>We note that while sending an IOC order immediately followed by a Day DAO order increases the chances of obtaining time priority on other marketplaces, no market place can guarantee that a “Sweep and Post” will always be first in line.</p> <p>Consequently, we note that this combination of IOC bypass orders followed by a Day order at a new price should also be applied when attempting to sweep and set a new price level on other marketplaces as well.</p>
<p>Opt-out broker preferencing</p>	<p>CSTA - It is difficult to rationalize a bona –fide reason to opt out of broker preferencing since resting orders can only degrade its execution options by opting out of broker preferencing.</p>	<p>This option was proposed to help resting anonymous orders manage their pre/post trade anonymity as it relates to broker preferencing (See response to Omega’s comment above). Opting-out of broker preferencing has been removed and all</p>

² http://www.osc.gov.on.ca/documents/en/Securities-Category2/rule_20091113_21-101_new-noa-21-101and23-101.pdf

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		attributed orders on the platform will be eligible for broker preferencing.
Good 'Till Orders	CSTA - We believe the definition for Good Till Date and Good till Cancelled to be cancelled at the end of the day is confusing.	Good Till Date allows for orders to be automatically cancelled intra-day by specifying an expiry time. Good Till Cancelled orders are accepted to facilitate integration by automated systems.
Marketplace liability	ITG – We need to address the nature of marketplace liability now, before a new wave of trading venues is allowed to begin operating.	The issue of marketplace liability is outside the context of CX2's Notice of Publication. However, CX2 will follow any direction that the CSA may provide regarding this issue in the future.