

**LIQUIDNET CANADA
NOTICE OF PROPOSED CHANGES AND REQUEST FOR COMMENT**

Liquidnet Canada is publishing this Notice of Proposed Changes in accordance with the “Process for the Review and Approval of the Information Contained in Form 21-101F2 and the Exhibits Thereto.” Market participants are invited to provide the Commission with comment on the proposed changes.

Comment on the proposed changes should be in writing and submitted by December 26, 2016 to

Market Regulation Branch
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and

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Comments received will be made public on the OSC website. Upon completion of the Review by OSC staff, and in the absence of any regulatory concerns, notice will be published to confirm the completion of Commission staff’s review and to outline the intended implementation date of the changes.

Any questions regarding the information below should be addressed to:

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Liquidnet Canada proposes to introduce the following change to the Liquidnet Canada trading system:

1. Targeted invitation functionality for trading of equity securities

A. Description of the proposed change

Liquidnet Canada is proposing to provide Canadian institutional clients with access to targeted invitation functionality for trading equity securities on the Liquidnet Canada ATS (for Canadian equities) and affiliated trading systems operated by its foreign affiliates (for non-Canadian equities).

Background

Liquidnet Canada and its global affiliates operate block crossing systems for institutional investors in 44 countries around the world. A review of available historical average trade volume and trade value statistics across leading Canadian exchanges and marketplaces demonstrates that Liquidnet Canada – with an average negotiated trade size of 65,000 shares¹ – is focused on block executions between institutional investors. These are the most efficient types of executions and provide the largest cost savings to long-term investors. As an extension of Liquidnet’s existing negotiation functionality, our global affiliates have implemented targeted invitations in 42 other markets worldwide, including the United States and twenty-six (26) markets in Europe. In our other regions, the average trade size for executions resulting from targeted invitations is significantly larger than the average trade size for negotiated executions. Because it is consistent with Liquidnet Canada’s block-trading focus, and will provide institutional investors with an additional tool for accessing large-in-scale liquidity, while mitigating market impact and information leakage, Liquidnet Canada wishes to enable Canadian Members to participate in this functionality, as described more fully below.

Existing negotiation functionality

Members can interact with Liquidnet Canada by transmitting non-binding indications, which means that a further affirmative action must be taken by the trader before an executed trade can occur. For Members that elect to participate in Liquidnet’s negotiation functionality, Liquidnet transmits indications received from the Member to Liquidnet’s indication matching engine. When a trader at a Member firm (a “trader”) has an indication in Liquidnet that is transmitted to Liquidnet’s indication matching engine, and there is at least one other trader with a matching indication on the opposite side (a “contra-party” or “contra”), Liquidnet notifies the first trader and any contra. A matching indication (or “match”) is one that is in the same equity and instrument type and where both the trader and the contra are within each other’s minimum tolerance quantities.

Liquidnet negotiations are anonymous one-to-one negotiations through which traders submit bids and offers to each other. The first bid or offer in a negotiation is submitted when one trader sends an invitation. Subsequent bids and offers may be submitted as counter-bids or counter-offers in the negotiation. An execution occurs when one trader’s proposal is accepted by the contra.

Existing H2O/auto-execution functionality

Liquidnet also offers functionality for the automated execution of non-displayed orders at the mid-price between the highest displayed bid and lowest displayed offer in the market. These orders include Liquidnet algo orders created by Members, customers or the Liquidnet trading desk, and other automated

¹For Q3 2016

orders created by Members, including LN auto-ex orders.² “Liquidity partners” (LPs), e.g., brokers, participate in this auto-execution functionality by transmitting immediate-or-cancel (IOC) orders to Liquidnet for execution. LPs do not have access to the Liquidnet desktop application and do not interact with the Liquidnet negotiation system.

Overview of the proposed targeted invitation functionality

When a natural, block-size match is not available in the Liquidnet Canada ATS, targeted invitations functionality enables buy-side Member firms to selectively widen their search for trading opportunities and draw otherwise latent, block-size liquidity to the marketplace by anonymously sending a targeted notification to one or more buy-side participants who have shown recent contra interest in trading a particular symbol, e.g., the participant had an opposite-side indication or execution in Liquidnet within a prior time period specified by the Member (referred to herein as a “look-back period”). Since targeted invitation notifications are objectively limited to Members who have demonstrated such contra-interest during a defined look-back period, information leakage, and associated market impact, is minimized.³

A targeted invitation has a notification component and, if there is at least one qualifying recipient for the targeted invitation (as described below), results in a firm order (a “targeted invitation order”) available for auto-execution via Liquidnet H2O functionality and an indication available for matching in the Liquidnet negotiation system (as described above). The targeted invitation order can execute against buy-side contra orders regardless of whether the contra was actually a recipient of the targeted invitation notification.

Targeted invitations functionality is an optional feature. Members, i.e., buy-side institutions, must affirmatively opt-in to be eligible to receive targeted invitations and send two-way targeted invitations (as defined below). Members who opt-in understand that they must meet objective eligibility requirements. To qualify for any quarter, a Member must meet either of the following conditions (or set of conditions):

- Average daily liquidity of USD \$100M or more provided to Liquidnet during either of the two prior quarters
- Positive action rate (PAR) above a specified percentage during either of the two prior quarters.⁴

A Member who meets either of these conditions is referred to herein as a “Qualifying Member”. As discussed in more detail below, only Qualifying Members can receive targeted invitations.

While a detailed description of targeted invitations functionality is provided below, we wish to highlight the following important characteristics:

- The proposed minimum order size for targeted invitations for Canadian equities is the lesser of 25,000 shares and 15% ADV. Similar minimum sizes apply for other markets.

² A Liquidnet algo order employs a strategy to execute an order according to Member-specified parameters, e.g., limit price. Liquidnet auto-ex orders can access the Liquidnet negotiation and H2O functionality, but cannot access external venues.

³ For US equities, during the period March 14, 2016 through Sept. 30, 2016, for targeted invitations where there has been at least one eligible recipient, there has been an average of 2.7 recipients per targeted invitation sent.

⁴ Positive action rate is a measure of how often a Member positively responds to trade opportunities on the Liquidnet system.

- Targeted invitations functionality is currently available in 42 of the 44 markets where Liquidnet trades and participating Member firms have traded more than US\$2.6 billion in global notional value to date. More than 400 global Member firms are enabled for targeted invitations; each of these firms has affirmatively opted in to participate in targeted invitations functionality.

One-way and two-way targeted invitations

There are two types of targeted invitations:

- Two-way targeted invitations
- One-way targeted invitations.

In a two-way targeted invitation, the sender receives certain information regarding the actions of the recipients. More particularly, the sender of a two-way targeted invitation is notified when a recipient indicates interest and requests more time and, if a sender elects to have his or her two-way targeted invitation order automatically cancelled when all recipients have dismissed the targeted invitation notification, the sender can determine that all of the targeted invitation notifications sent by the sender have been dismissed by any recipients. The sender of a two-way targeted invitation is also notified if there are no qualifying recipients.

One-way targeted invitations are an optional parameter associated with algo orders and LN auto-ex orders (discussed above) by which a trader creating such an order may authorize Liquidnet to send a targeted invitation on the trader's behalf. In a one-way targeted invitation, the sender does not receive information regarding the actions of the recipients.

Qualifying Members

As noted above, only Qualifying Members can receive targeted invitations. Qualifying Members also can send two-way targeted invitations and one-way targeted invitations. Members that are not Qualifying Members cannot receive targeted invitations, and can send one-way targeted invitations, but not two-way targeted invitations.

Members that do not opt in to targeted invitations cannot receive targeted invitations and can only send one-way targeted invitations. By opting in to targeted invitations, a Member opts in to Liquidnet accessing the Member's indication, invitation and execution data to determine the Member's qualification to receive a targeted invitation, as described below. Any opt in to targeted invitations applies to all regions where this functionality is available, unless otherwise instructed by a Member.

Description of two-way targeted invitation functionality

Through the Liquidnet desktop application, a trader at a Qualifying Member firm can send a two-way targeted invitation notification relating to a specific stock to other Qualifying Members.

A two-way targeted invitation has a notification component, and, if there is at least one qualifying recipient for the targeted invitation (as described below), results in a firm order available for auto-execution in Liquidnet (a "targeted invitation order") and an indication available for matching in the Liquidnet negotiation system. A targeted invitation order can execute against contra-side orders within the Liquidnet

negotiation and auto-execution systems in the same manner as other algo orders executing within the Liquidnet system, subject to the following exceptions:

- The notification component of the targeted invitation notifies qualifying recipients about the presence of the order
- Two-way targeted invitation orders cannot execute against orders from brokers.

Setting criteria for who can receive a targeted invitation notification

When creating a two-way targeted invitation, a trader must designate a look-back period. A trader can select the current trading day as the look-back period or the current trading day plus any of the following periods: 1, 5, 10, 15, 20, 30, 45, 60, or 90 prior trading days.

By default, a targeted invitation notification is sent to traders at Qualifying Members where the recipient trader meets any of the following criteria:

- ***Opposite-side indication in Liquidnet.*** Liquidnet received an opposite-side indication from the recipient at any time during the look-back period, where the available quantity was at least the minimum matching and negotiation size for the applicable market. For example, for Canadian equities, the minimum matching and negotiation size is the least of 5,000 shares, 5% of ADV and CAD\$ 100,000, meaning that a qualifying recipient must have transmitted an opposite-indication of at least that size to Liquidnet during the selected look-back period to receive a targeted invitation in a given symbol.
- ***Opposite-side indication placed away.*** The recipient has or had an opposite-side indication in its order management system (OMS) at any time during the look-back period where the quantity placed at other brokers is or was at least the minimum matching and negotiation size for the applicable region.
- ***Opposite-side execution in Liquidnet.*** The recipient executed in Liquidnet with anyone at any time during the look-back period, where the recipient executed on the opposite-side to the sender's order (for example, the recipient executed a buy order and the sender's targeted invitation is for a sell order) and the recipient's execution quantity was at least the minimum matching and negotiation size for the applicable region.
- ***Executed against sender.*** The recipient executed in Liquidnet against the sender at any time during the look-back period, where the execution quantity was at least the minimum matching and negotiation size for the applicable region.
- ***Invited the sender.*** The recipient sent the sender a negotiation invitation or targeted invitation notification at any time during the current trading day.

All targeting criteria are applied for the specific stock. The foregoing is subject to the exceptions described below.

Traders with same-side indications

A trader is not eligible to receive a targeted invitation notification in a symbol if the trader had at least one same-side indication in the symbol (a) in the same trading period as its most recent opposite-side indication or (b) in a more recent trading period than its most recent opposite-side indication.

Setting alternate criteria for who can receive a targeted invitation notification

By default, among the other criteria noted above, a targeted invitation notification is sent to traders at Qualifying Members where the recipient trader has (i) executed against the sender of the targeted invitation in that symbol during the look-back period or (ii) sent a negotiation invitation or a targeted invitation notification in that symbol at any time during the current trading day. Through the desktop application, a trader can further specify that a two-way targeted invitation notification will only be sent to recipients that meet either or both of those criteria.

Targeted invitations not available where a match exists

A trader can only create a two-way targeted invitation based on an unmatched indication. A trader cannot create a two-way targeted invitation or receive a targeted invitation notification on a stock where the trader has a matched indication in the Liquidnet negotiation system.

Hours of availability

A trader can only create a targeted invitation during the regular trading hours of the primary listing market for the applicable country.

Order details for a targeted invitation

For any targeted invitation, a sending trader must specify the following:

- **Quantity.** The quantity of a two-way targeted invitation defaults to the trader’s working quantity on the indication. Quantity cannot be greater than the working quantity on the indication and cannot be less than the minimum execution size noted in the bullet below.
- **Minimum execution size.** The default minimum execution size for a two-way targeted invitation order for Canadian equities is the lesser of 25,000 shares and 15% of ADV. The minimum execution size for a two-way targeted invitation order cannot be greater than the working quantity on the indication and cannot be less than this default minimum execution size.
- **Limit price.** At the time that a two-way targeted invitation is first sent, the limit price specified by a sender must be at or above the current mid-price, in the case of a buy targeted invitation, or at or below the current mid-price, in the case of a sell targeted invitation.
- **Maximum number of recipients.** A sender can select a maximum number of recipients for a two-way targeted invitation notification.
- **Time-in-force.** A sender must specify a time-in-force for a two-way targeted invitation, which cannot be less than a specified minimum time period. A targeted invitation expires upon the earlier of (i) expiration of the specified time-in-force, and (ii) the end of the current trading day. A

trader may cancel a two-way targeted invitation prior to the expiration of the specified time-in-force period. Expiration (or cancellation) of a two-way targeted invitation results in the expiration (or cancellation) of the applicable targeted invitation notification and order. Liquidnet may terminate a Member's participation in two-way targeted invitation functionality based on repeated cancelations.

Prioritization of recipients

Where the number of qualifying recipients exceeds the maximum number of recipients specified by the sender, Liquidnet prioritizes the recipients based on a set of prioritization rules that Liquidnet may update from time-to-time. For example, a Member that has a current indication in Liquidnet has priority over a Member that does not have a current indication in Liquidnet. Liquidnet maintains and provides to Members upon request the details regarding these prioritization rules.

Receiving a targeted invitation notification

A targeted invitation notification is notified to a qualifying recipient through the Liquidnet desktop application. The notification includes the sender's minimum execution size, but the recipient must take an action through the desktop application to view the sender's minimum execution size. A recipient is further made aware through the Liquidnet desktop application when a targeted invitation expires.

Notifications to sender and recipient concerning limit price

A recipient is notified through the desktop application if the sender's limit price is away from the mid-price (i.e., above the mid-price in the case of a targeted invitation sent by a seller or below the mid-price in the case of a targeted invitation sent by a buyer).

If the limit price of a sender of a two-way targeted invitation is away from the mid-price for a specified period, Liquidnet will provide the sender a notification to either adjust his or her limit price for the targeted invitation or cancel the targeted invitation.

Responses by recipient

A recipient has the following two options upon receipt of a targeted invitation notification:

- Notify the sender that the recipient is interested and request more time to respond to the targeted invitation
- Dismiss the notification.

If a trader dismisses a notification in a symbol, the trader cannot receive another targeted invitation notification for that symbol for the rest of that trading day, but the trader can send a targeted invitation in that symbol.

A recipient also can take any other action permitted by the trading system, including the creation of an opposite-side indication or order.

Information received by the sender regarding recipients

As noted above, a sender of a two-way targeted invitation is notified when a recipient indicates interest and requests more time. If a trader elects to have his or her two-way targeted invitation order automatically cancelled when all recipients have dismissed the targeted invitation notification, the trader can determine that all of the targeted invitation notifications sent by the sender have been dismissed by any recipients.

Description of one-way targeted invitations

Targeted invitation functionality will also be available for LN auto-ex orders and for certain types of Liquidnet algo orders. Liquidnet refers to this functionality as “one-way targeted invitations”.

Liquidnet intends to introduce one-way targeted invitations through a series of releases over a period of time, subject to prior notice to participants. Liquidnet will introduce this functionality in five phases, as follows:

- Phase 1: Orders initiated by Liquidnet trading desk personnel pursuant to customer instructions (known as “high-touch” orders)
- Phase 2: Orders created directly by trading desk customers via their order management system (known as “low-touch” orders)
- Phase 3: Algo orders created through the Liquidnet desktop application
- Phase 4: Orders transmitted via an automated router on behalf of buy-side institutions who do not have the Liquidnet desktop application (currently applies to non-Canadian equities only)
- Phase 5: LN auto-ex orders.⁵

The provisions above that do not specifically reference two-way targeted invitations are also applicable to one-way targeted invitations, except as otherwise set forth below.

One-way targeted invitations for low-touch orders from customers

For low-touch orders, subject to the customer’s consent, Liquidnet can send targeted invitation notifications to Members that are qualifying recipients. Liquidnet will apply certain default configurations for maximum number of recipients, look-back period, minimum execution size, and time-in-force for these notifications. Liquidnet may change the default maximum number of recipients and default look-back period from time-to-time.

Upon request by a Member, Liquidnet can adjust these default configurations. Any such configuration for a Member or customer applies to all one-way targeted invitations sent by the Member or customer.

One-way targeted invitations for high-touch orders from customers

For high-touch orders, subject to the customer’s consent, a Liquidnet trader can elect to authorize Liquidnet to send targeted invitation notifications for a particular order. Liquidnet applies the same default

⁵ As noted above, Liquidnet auto-ex orders can access the Liquidnet negotiation and H2O functionality, but cannot access external venues.

configurations, and permits adjustment of configurations, as described above for one-way targeted invitations for low-touch orders from customers.

Targeted invitations for Member orders created through the desktop application

For orders created by a Member through the desktop application (whether algo or LN auto-ex orders), the Member can authorize Liquidnet to send one-way targeted invitation notifications to other Members that are qualifying recipients. Liquidnet applies the same default configurations, and permits adjustment of configurations, as described above for one-way targeted invitations for low-touch orders from customers.

Consent to sending of one-way targeted invitations

Liquidnet will not send one-way targeted invitations for a Member or customer order unless consented to by the Member or customer.

Guidelines for determining when to send a one-way targeted invitation

Liquidnet does not automatically send a one-way targeted invitation for any algo or LN auto-ex order. Instead, Liquidnet applies various guidelines concerning order size and priority in determining whether and when to send a one-way targeted invitation. These guidelines are disclosed to Members and only apply if the Member or customer has consented to Liquidnet sending a one-way targeted invitation. Liquidnet may modify these guidelines based on its review of Member and customer usage.

Cancellation of one-way targeted invitations

Liquidnet will cancel any one-way targeted invitation notifications for an order upon the occurrence of certain conditions relating to remaining order size, limit price, customer cancellation or expiration of the associated order. Expiration or cancellation of a one-way targeted invitation notification does not affect the related order.

Resending of a targeted invitation after a cancel

Liquidnet can resend a targeted invitation after a cancel.

No notifications to senders of one-way targeted invitations

A sender of a one-way targeted invitation is not notified of any of the following:

- Whether or not there are any qualifying recipients
- When a recipient indicates interest or requests more time
- When all recipients have dismissed the targeted invitation notification.

B. The expected date of implementation

It is expected that the proposed change will be implemented following the later of (i) the date that Liquidnet Canada is notified that the change is approved and (ii) the date all applicable regulatory requirements have been met.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed functionality to provide Canadian participants with the ability to draw otherwise latent, block-size liquidity to the marketplace, while still minimizing information leakage. Institutional investors in the United States, Europe, Asia, Australia and Africa utilize this functionality to reduce trading costs for their customer orders, and Canadian participants should have the same opportunity.

D. Expected impact of the proposed change on market structure, subscribers, investors and capital markets

As proposed, targeted invitations functionality would permit notifications concerning otherwise dark orders to some, but not all, participants of the Liquidnet Canada ATS, based on objective criteria and parameters specified by the sender. Liquidnet Canada respectfully submits that the pre-trade transparency requirements of sections 7.1 and 7.3 of NI 21-101 should not apply to such targeted invitations orders for at least the following reason.

The pre-trade transparency requirements of sections 7.1 and 7.3 of NI 21-101 are intended to require display of orders that would customarily be posted on a lit marketplace, i.e., where exposure would not negatively impact the order holder. In discussing the rationale and benefits of dark pools and dark orders, the CSA has recognized that block-size orders – like those associated with targeted invitations – would typically not be placed on a lit marketplace:

Dark Pools were introduced to enable investors to place large orders anonymously without displaying them to the public in order to minimize the market impact costs associated with placing such large orders in a visible book. This could be achieved through institutions trading large volumes among each other anonymously, or through large orders that may have otherwise traded only in the upstairs market, being entered on a marketplace where they can interact with other orders from other investors without being displayed.⁶

Consequently, we foresee no adverse impact on market structure, subscribers, investors or the capital markets because the proposed change will only help participants draw otherwise latent liquidity to the marketplace and reduce trading costs for their customer orders.

E. Expected impact of the proposed change on Liquidnet Canada's compliance with Ontario securities law and the requirements for fair access and maintenance of a fair and orderly market

Liquidnet Canada respectfully submits that the proposed functionality is consistent with the underlying purpose of the fair access requirements. As noted in subsection 7.1(1) of Companion Policy 21-101CP, the requirements regarding access for marketplace participants “do not restrict the marketplace from maintaining reasonable standards for access” to marketplace services. And the purpose of the access

⁶ Joint CSA/IIROC Position Paper 23-405, Dark Liquidity in the Canadian Market, November 19, 2010, at page 10768, http://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20101119_23-405_dark-liquidity.pdf (accessed May 11, 2016)(the “Position Paper”).

requirements “is to ensure that rules, policies, procedures, and fees, as applicable, of the marketplace do not unreasonably create barriers to access to the services provided by the marketplace.” Consistent with this stated purpose, targeted invitation recipients are determined based purely on reasonable and objective criteria – there are no subjective factors at play and no unreasonable barriers to participation.

A plain reading of the text of subsection 5.1(3) of NI 21-101 indicates that a marketplace may indeed implement participation criteria that result in limited access to certain products or services as long as those criteria do not result in “unreasonable discrimination” among participants or “impose any burden on competition that is not reasonably necessary and appropriate.” As discussed above, the objective participation criteria proposed for targeted invitations are designed to attract latent liquidity while minimizing information leakage and associated market impact of a block-size order. In this context, these criteria do not permit unreasonable discrimination among participants or impose any unreasonable or inappropriate burdens on competition.

Consequently, we foresee no adverse impact on Liquidnet Canada’s compliance with market structure, Ontario securities laws or to requirements of fair access and the maintenance of a fair and orderly market.

F. Consultations undertaken in formulating the proposed change, including internal governance process followed

Liquidnet Canada consulted with certain customers before proceeding with the proposed change. The proposed change was approved by the management of Liquidnet Canada.

G. Whether the proposed change will require subscribers and vendors to modify their own systems

The proposed change does not constitute a material change to “technology requirements regarding interfacing with or accessing the marketplace” within the meaning of Part 12.3 of NI 21-101 because subscribers and service vendors will not be required to do any significant amount of systems-related development work or testing to enable the proposed functionality or fully interact with the Liquidnet Canada ATS as a result of the proposed change. More particularly, the proposed change will not require participants or service vendors to make any changes to the way they currently interface with, service or access the Liquidnet Canada ATS from a technology perspective. The proposed functionality has already been developed and implemented in other jurisdictions, so Liquidnet Canada need only enable Canadian subscribers for this functionality in order to implement the proposed change.

H. Whether the proposed change would introduce a fee model or feature that currently exists in other markets or jurisdictions

Liquidnet Canada’s affiliates in other jurisdictions have already implemented the proposed functionality in 42 other markets across the United States, Europe, Asia, Australia and Africa.