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and

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Via Email

Re: Request for Comments – Amendments Concerning Definition of TSX Ask, TSX Bid and TSX Closing Price

Scotiabank appreciates the opportunity to comment on the proposal by TSX Inc. (“TSX”) to provide definitions for closing valuations which diverge from traditional techniques when applied to thinly-traded securities including ETFs.

We broadly support industry initiatives which help in providing reasonable, consistent end-of-day valuations for thinly-traded securities. The sole initiative in this area to date has been NEO Exchange’s efforts to provide an alternative closing price for exchange-traded funds listed on NEO. We support TMX Group’s proposal to extend the ideas pioneered by NEO to TSX-listed securities.

We believe a significant shortcoming of current Canadian practices is the widespread reliance on the listing exchange’s last published board lot trade (for “official closing price”) and last published bid & ask price (for IIROC-approved valuations of listed securities). This approach creates challenges and limitations when applied to thinly traded securities (where the listing exchange’s last board lot trade may be stale), and in a multi-marketplace environment (where the last board lot may have traded on a venue other than the listing exchange).

Similarly, reliance on the last observed bid-ask leaves data consumers with the possibility that quote fade artificially distorts prevailing market prices, particularly for thinly-traded ETFs – where robust

quoting normally exists until 4:00 PM market close, but where quote fade into the close and in the extended session is also commonplace. This has the effect of leaving users, particularly within the retail investment community, exposed to official security valuations that are significantly different (and typically worse) than where the same security could have been traded shortly before 4:00 PM market close. The effect is to reduce confidence in the market for thinly-traded securities, and in particular certain ETFs, to the detriment of the investors.

We believe the TSX proposal is an important incremental step for the following reasons:

- For common equity securities, setting the official bid-ask at 4:00 PM rather than at 5:00 PM eliminates the quote fade which occurs through the TSX extended session. We believe the 4:00 PM snapshot is more representative of liquidity conditions at the end of the business day than a snapshot at 5:00 PM would be.
- For ETF securities, a calculated valuation based on 10-minute TWAP for bid, ask and the closing price would provide a robust and reasonable indicative snapshot of market conditions at the end of the trading day in situations where no trades took place in the market. These calculated prices are a significant improvement over a stale prior trade price, which in some instances would have occurred many days previously.
- The dissemination of the proposed data elements through changes to existing market data feeds, rather than through a zero-volume trade or FTP site (as in NEO's implementation), will greatly increase the range of downstream users that could take advantage of these calculated valuations.

While we support the proposal, we believe it does not go far enough to address the issues in their entirety. We therefore suggest the following additional measures, some of which exceed the scope of TMX Group jurisdiction:

First, we believe that the calculated values being proposed for ETF securities are equally appropriate for any and all thinly-traded securities in Canada. The mechanics that the ETF market relies on is largely invisible to ETF investors, who trade in the secondary market. From the perspective of investors, ETF transactions are equivalent to trades in any other thinly-traded security. The calculations proposed also have no connection to any ETF feature, other than simply classifying a security as an ETF. We therefore believe investor experience in other segments of the Canadian market will equally benefit from "ETF-style" closing valuations in situations where the security is infrequently traded. In particular, we believe Canadian preferred shares, convertible debt instruments and small-cap equities will all benefit from this approach.

Second, we would encourage all other Canadian listing exchanges to adopt a similar methodology for thinly-traded securities. Investors in Canada deserve consistency in how their portfolio holdings are

represented, regardless of listing venue. We therefore hope to see NEO Exchange adapt their existing ETF alternative closing valuation approach to the same 10-minute time window. We also hope to see concurrent changes from TSX Venture Exchange, the Canadian Securities Exchange, and any other Canadian exchange looking to list equities. This approach would provide uniformity in end-of-day valuation and support investor confidence in Canadian markets.

Third, we believe the value of the calculations presented will be improved if they are based on the consolidated market quotations and not just the TSX BBO. We therefore ask that TMX Group explore with other marketplaces the possibility of including away quotes in the derived closing valuation calculations. We further ask that marketplaces contributing to the NBBO allow TMX Group to use their data for this purpose at no incremental cost. Similarly, TMX Group should provide their data for similar calculations at other listing markets should those needs arise in the future. This approach would allow end of day valuations to represent the trading conditions of the entire Canadian market, rather than simply the trading conditions on one marketplace.

Fourth, we believe that the methodology can be improved by consistently representing the TSX Bid and TSX Ask for ETFs and stocks, with a common methodology. The purpose of averaging the BBO over the final 10 minutes of trading is to overcome data quality issues, particularly in cases where a security is thinly-traded. The same data integrity concerns are lessened when price discovery occurs in the market. We therefore suggest that:

- In situations where a security has not traded in the last 10 minutes of regular market hours, the BBO is represented as the 10-minute TWAP of the displayed bid and offer respectively. This is the methodology currently proposed for all ETFs.
- In cases where a trade has occurred in the final 10 minutes, the closing BBO is observed immediately after the last board lot trade has taken place, including in the closing auction. This approach would capture the market impact of the last execution of the day, including the impact of the closing auction. In the case of frequently-traded securities, and all securities where a closing auction has taken place, it would be functionally equivalent to the closing price snapshot at 4:00 PM currently proposed for common stocks.

Finally, and crucially, the utility of these calculated valuations depends heavily on the acceptance of these calculations by regulatory bodies. Specifically, we believe a significant constraint to resolving the broader issue of “unstable valuations for thinly-traded securities” is the codification of valuation approach in IIROC Dealer Member Rule 200 and Form 1. We ask that IIROC, in collaboration with the CSA, to investigate suitable amendments to the Dealer Member Rules to permit dealers to use derived valuations such as those proposed by TMX Group and NEO Exchange. These alternate valuations should flow seamlessly into existing back office processes and be applied in the same manner as closing bid-ask are applied today – leading to a smooth implementation for the dealer community.

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We appreciate the opportunity to comment on this matter. We stand ready to assist in this effort in any way we can.

Respectfully,

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