January 28, 2022

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Dear Sirs / Mesdames:

Re: Canadian Securities Exchange Notice of Proposed Changes and Request for Comment

TMX Group Limited ("TMX Group" or "we") welcomes the opportunity to comment on the Notice and Request for Comment (the "Notice") as published by the Ontario Securities Commission (the "OSC") on December 9, 2021 on behalf of Canadian Securities Exchange ("CSE") outlining a proposal to introduce differentiated fee models for CSE's Guaranteed Minimum Fill Facility ("GMF"), for GMF-eligible and non-GMF-eligible orders, applicable to TSX and TSXV listed securities trading on the CSE ("proposal" or "fee proposal").

While TMX Group is fundamentally supportive of innovations designed to improve the liquidity and execution environment for the investment community within Canada, we believe that there are material concerns about the fee proposal that the OSC and British Columbia Securities Commission (the "BCSC", and together with the OSC, the "Commissions") should consider and address. As a result, we are not supportive of the Commissions approving the fee proposal as described in the Notice. TMX Group cites the following concerns:

1) **Retail Segmentation**
We believe that the proposed fee model, which differentiates between CSE's GMF-eligible and non-GMF-eligible orders, in conjunction with the marketplace dynamics of the GMF facility, will further exacerbate the segmentation of retail flow and move towards synthetic Payment for Order Flow ("PFOF") type arrangements in Canada. The potential impacts are increased opportunity costs and adverse selection costs for orders displayed on other

markets that will increasingly be denied both the opportunity to trade sooner and interact with more desirable retail order flow. In addition, the proposal is inconsistent with the intended use of guaranteed facilities and is also inconsistent with the application of Canadian dark trading rules.

2) **Information Leakage**
We are concerned that the fee model could provide information to CSE passive participants based on the different passive rebates / fees depending on order type. This information gives an unfair informational advantage over passive participants on other markets or those that have not received a fill.

We elaborate on each of these concerns below.

We also note that this proposal was previously put forward in 2016 and subsequently withdrawn due to concerns raised by the industry. We question whether the concerns raised have been adequately resolved.

Retail Segmentation

The proposed fee model highlights growing usage and interest in segmenting order flow by introducing two different and distinct fee models on the same marketplace – a) an inverted fee model for GMF-eligible orders; and b) a traditional maker-taker fee model for non-GMF-eligible orders. GMF-eligible orders, which are limited to a size less than the GMF, and are not from a client involved in active or continuous trading, effectively capture smaller natural orders that are generally considered retail. Therefore the inverted fee model for GMF-eligible orders segments retail orders from non-retail orders by offering a rebate exclusively for retail orders. When combined with the GMF facility, this will facilitate additional segmentation of retail order flow on visible markets by allowing a further extension of 'one-to-many' market mechanisms where the 'one' are 'market makers' on securities for which CSE is not the listing exchange, and the 'many' will effectively (or even explicitly) be limited to retail order flow. The potential impacts are increased opportunity costs and adverse selection costs for orders displayed on other markets that will increasingly be denied both the opportunity to trade sooner and interact with more desirable retail order flow.

The current usage of the GMF facility goes against what we believe should be the intended use case for guaranteed fill facilities, which is to provide liquidity *of last resort,* and instead the proposal encourages and promotes retail interactions against market makers ahead of visible liquidity. The first guaranteed fill facility in Canada, the TSX MGF Facility, was designed to provide small investor orders with guaranteed fills to supplement the displayed CLOB. It does so by only executing the MGF after all visible and hidden liquidity at the same price level has first been executed. Previously, when TSX was the only marketplace trading TSX-listed securities, the MGF fill was truly the liquidity of last resort as all visible liquidity had been exhausted. Even now, in a multi-marketplace environment, we would expect active orders to be sent last to the TSX MGF due to the maker-taker fee structure; thus, MGF is the last liquidity left at that price level. This liquidity is available on **all** TSX-listed securities, even on less liquid ones, as part of the TSX Market Making obligations.

As noted above, the GMF is not providing liquidity of last resort. While GMF fills are also only executed after all visible liquidity has been executed, the inverted fee structure incentivizes the use of the GMF as the "first look" liquidity, since fee-sensitive active GMF-eligible retail orders are routed to CSE first to secure a rebate, and the market maker pays a passive fee for executing against these orders. This is a synthetic on-exchange PFOF style arrangement, where only the active retail order gets a rebate (funded by the passive market maker fee) while the broader non-retail market pays active fees.

The degree of retail order flow interaction against the market maker is especially large on CSE, given its small top of book liquidity size. In 2021, on average, CSE had only 2% of the volume at CBBO[1]. This means that when a GMF-eligible order executes against CSE visible liquidity, it is only executing against 2% of the total visible volume available at the best bid or offer, leaving 98% of the visible liquidity at that price level on other Canadian marketplaces unexecuted prior to executing against the market maker on CSE. We note that the average CBBO volume of a TSX-listed security is 22,501 shares[2], and when viewed in light of this average, that means that GMF-eligible orders only execute an average of 450 shares against the visible liquidity, with the remaining executing against the market maker. For example, assuming the maximum size of the GMF at 50 board lots, an order of 5,000 shares at $10 marked as a GMF eligible would execute as follows, rounded to the nearest board lot: 500 shares would execute against the visible volume and 4,500 shares (or approximately 90% of the order) would automatically execute against the market maker without getting exposed to any other orders. We believe that such 4,500 shares should be allowed to execute against visible orders on other Canadian marketplaces first before relying on the market makers. The fee proposal incentivizes and encourages market segmentation, and creates the potential for increased opportunity costs and adverse selection costs for orders displayed on other markets that are denied the opportunity to interact with this flow.

Furthermore, we believe the fee proposal indirectly goes against the principles of Canadian dark rules by allowing smaller-sized hidden GMF liquidity to execute at the touch, without offering price improvement.

As noted above, we believe that all guaranteed fill facilities should execute against all displayed liquidity across all Canadian marketplaces first prior to triggering a guaranteed fill against the market maker. This would ensure that displayed liquidity, on all marketplaces, receives priority over "hidden" market maker liquidity.

Leakage of Information

The fee proposal, if approved, will be the first fee model in Canada that gives a different passive fee or rebate depending on whether a participant interacts with a GMF-eligible order or not, regardless of whether there is a GMF fill. This means that passive participants would be able to determine whether they interacted with a GMF-eligible "retail" order or non-GMF-eligible order on **every** execution.

While our understanding from the proposal is that this information is only available at the end of the day (at approximately 6:30 pm each trading day), there are often large institutional orders that execute over multiple days, and this information would still be relevant in helping to determine, on a symbol basis, the approximate proportion of non-GMF-eligible trades compared to GMF-eligible trades, as a proxy for institutional trading versus retail trading. This is information that would only be available to passive participants on CSE and not participants on other marketplaces. This informational advantage would be proportional to the size of the trading done on CSE, which would advantage larger firms.

Impact on Canadian Marketplace

We ask the Commissions to consider whether the fee proposal would open the door for other Canadian marketplaces to introduce similar "first look" retail-focused guaranteed fill facilities in conjunction with inverted fee models aimed at reproducing a PFOF type structure. The fee proposal raises the possibility of these facilities being marketed to retail trading desks as an implicit PFOF type structure. This would further segment retail flow as it would get siphoned off by market makers.

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[1] In 2021, the average time-weighted % CBBO volume on TSX-listed securities was 2%

[2] In 2021, the average time-weighted CBB volume on TSX-listed securities was 22,501 shares

We also caution that while we are not supportive of the proposal, wide scale adoption of such practices will force other market operators (TMX included) to follow suit in order to remain competitive, further exacerbating the issue. We feel strongly that the end result will have a negative impact on Canadian market structure, resulting in the majority of retail order flow only executing against market maker liquidity.

Conclusion

TMX Group appreciates the opportunity to comment on the fee proposal. We feel that this proposed fee structure, which differentiates fees based on GMF-eligible orders, would exacerbate segmentation of order flow by promoting “first look” PFOF-style guaranteed execution fill facilities, which the GMF is one of. We hope that this starts a general review on guaranteed fill facilities, which we would be happy to be part of, to the betterment of Canadian capital markets.

Sincerely,

“Rizwan Awan”

Rizwan Awan
President, Equities Trading
TMX Group Limited