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VIA EMAIL

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Joacim Wiklander
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Cc:

Re: Proposed Public Interest Rule Amendment and Request for Comments regarding Directed Indication of Interest ("Notice")

Dear Mr. Wiklander:

Nasdaq CXC Limited ("Nasdaq Canada" or "we") welcomes the opportunity to provide comments on CBOE Canada Inc.'s ("CBOE") proposal to introduce directed indications of interest for its MATCHNow trading book. ("Proposal"). While we recognize that Directed IOIs may create efficiencies by automating a manual process used today to trade large blocks in the "upstairs" market, these types of orders when offered by an exchange violate several marketplace rules and if approved will represent a significant deviation from the current regulatory framework and the market structure it supports in Canada today. We therefore respectfully encourage the OSC to not approve the Proposal in its current form on this basis.

General Comments

As a general principle, Nasdaq Canada supports innovative products and services introduced by marketplaces for participants facilitated through technology and automation. However, given the unique characteristics of the Canadian equity market it is imperative that any new feature introduced to the market not be inconsistent with the current regulatory regime. Should the Proposal be approved in its current form it will create a significant deviation from Canada's existing market principles and in turn will introduce a dangerous precedent leading us down a slippery slope that could harm market integrity and fairness.

Canada differentiates its market structure and regulatory framework from the US for good reasons. Robust fair access requirements, the prohibition of off-exchange trading, and the restrictions on explicit customer segmentation and counter party selection (to date) help support a healthy public market and ecosystem that encourages participation across classes of participants. Maintaining these standards is important to preserving the vitality of the Canadian market which already is under competitive pressure for inter-listed securities from the US. It would also protect the robust price formation process used in Canada for capital raising and valuations. Because of Canada's smaller size (approximately 10% of the US market) and the high concentration of order flow handled by a small number of dealers, it is critical that access to services and order flow is not restricted to only one or a limited number of participants and that creating explicit liquidity silos is not permitted.

We understand from the Notice that while the functionality being proposed is intended to replicate a similar dealer workflow in the "upstairs" market, the different rules governing dealer desks and marketplaces need to be considered. Whereas dealers are not subject to fair access requirements and are also not required to consider the public interest when making business decisions, exchanges need to comply with both. As it stands today, the Proposal will violate fair access by allowing discrimination across clients, participants and firms, it will enable explicit customer segmentation and counterparty selection and will create silos of liquidity restricting access to order flow by other participants. While these outcomes may not violate CIRO rules they are inconsistent with National Instrument 21-101 *Marketplace Rules* (NI 21-101).

Specific Issues Raised by the Proposal

a. Discrimination violating the Fair Access provisions of NI 21-101.

Fair access in Canada generally means that all participants must be given the opportunity to use the same marketplace services and to interact with all orders on a marketplace. The Proposal introduces at least four areas of discrimination that violate fair access provisions.

- The Proposal discriminates against other classes of participants that are not subscriber users and are not able to gain access to the same order flow or information about the orders being communicated in the Directed IOIs sent to them;
- By allowing firms to send Directed IOIs to only specific clients of the firm the Proposal discriminates against other clients that do not receive the same execution opportunities or information in these circumstances;
- By allowing subscriber users that are clients of multiple dealers to select and restrict the number of dealers they will receive a Directed IOI from, the Proposal supports features that discriminate against other sponsoring firms; and
- By permitting order flow to be kept within the client network of a firm that supports institutional buy-side clients, other dealers that do not support this business line and are not users of BIDS are discriminated against.

b. Explicit Customer Segmentation and Counterparty Selection

In addition to the discriminatory practices the Proposal will introduce, we are also concerned about the impact of allowing features that facilitate explicit customer segmentation and counterparty selection. While there are market models that encourage certain types of order flow from certain types of customer segments such as inverted venues which are popular with dealers managing retail active flow, these models do not restrict access and can be used by all participants.

Not only does the Proposal provide the ability for a dealer to select the clients to which it wants to send Directed IOIs and from which dealers a client will receive Directed IOIs, it also allows subscriber users to select what kind of order flow they will interact with when receiving a Directed IOI. These features are new to the Canadian market and will set a dangerous precedent for the segmentation of order flow and counterparty selection.

c. Impact on Liquidity by Creating Silos

By restricting access to certain order flow to only specific dealers and subscriber users the Proposal will create silos of liquidity inaccessible by all participants. The impact of this effect will further be accentuated by the fact that access will be limited to large dealers with sizable institutional client bases and large institutional clients that use many dealers. While the US market is large enough to support this type of structure (whether it is good for the market is another question) Canada is smaller (as noted above) and likely would not be able to support such fragmentation of liquidity and limitation of access for some participants. If Canadian marketplaces are permitted to support features that facilitate the creation of silos these features could be used by Canada’s larger dealers to internalize significant levels of order flow that in turn would threaten the quality of the NBBO and price discovery.

Efficiencies Need to Comply with the Rule Set

While we recognize that creating market efficiencies provides certain benefits, these practices need to be compliant with regulatory requirements. The Notice spends time discussing the historical and current practices of the use of IOIs and justifies the Proposal by explaining how it addresses several disadvantages created from the current workflow of dealers today.

While we recognize that the proposed Directed IOIs may address certain disadvantages created from the use of IOIs used today, this same process while compliant with dealer regulation is inconsistent with marketplace regulation when incorporated into and offered by a system of an exchange. Dealers are not subject to fair access regulations or public interest considerations. While responsible for ensuring best execution for their clients, client contracts with differing fees and provisions can be negotiated on a bespoke basis. Similarly, when working a large order, a sales trader may only share information about that order with only their clients and not all clients of the firm depending on the size of the order and trading interest. Marketplaces while not being subject to best execution requirements (because they act as electronic venues matching orders and not as intermediaries of a trade) are required to provide services on a fair and equal basis to all participants. Furthermore, Exchanges like CBOE are required to ensure that business and regulatory decisions are in keeping with the exchange’s public interest mandate. Taken together, even if the Proposal stands to create efficiencies, without making changes to current rules it should not be approved.

Conclusion

While we recognize that Directed IOIs will automate a manual process used today in the "upstairs" market, their use when supported by an exchange violates several marketplace rules and if approved will represent a significant deviation from the current regulatory framework and the market structure supported in Canada today. We therefore respectfully encourage the OSC to not approve the Proposal in its current form on this basis.

We thank the OSC for the opportunity to provide comments and would welcome the opportunity to discuss further our views with staff.

Sincerely,

Nasdaq Canada