

**13.2.2 TSX Inc. – Enhancement of “Seek Dark Liquidity” Functionality – Notice of Proposed Amendments and Request for Comments**

**TSX INC.**

**NOTICE OF PROPOSED AMENDMENTS AND REQUEST FOR COMMENTS**

**ENHANCEMENT OF ‘SEEK DARK LIQUIDITY’ FUNCTIONALITY**

TSX Inc. (“TSX”) is publishing this Notice of Proposed Amendments in accordance with the “Process for the Review and Approval of Rules and the Information Contained in Form 21-101F1 and the Exhibits Thereto”.

Market participants are invited to provide comments on the proposed changes. Comments should be in writing and delivered by April 15, 2019 to:

Anastassia Tikhomirova  
Legal Counsel, Regulatory Affairs  
TMX Group  
300-100 Adelaide Street West  
Toronto, Ontario M5H 1S3  
Email: [tsxrequestforcomments@tsx.com](mailto:tsxrequestforcomments@tsx.com)

A copy should also be provided to:

Market Regulation Branch  
Ontario Securities Commission  
20 Queen Street West  
Toronto, Ontario M5H 3S8  
Email: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

Comments will be made publicly available unless confidentiality is requested. Upon completion of the review by Commission staff, and in the absence of any regulatory concerns, notice will be published to confirm completion of Commission staff’s review and the Commission’s approval.

**Background**

TSX is planning to enhance the current Seek Dark Liquidity (SDL) functionality to provide increased opportunity for users to achieve larger overall fills and potential price improvement when employing cross-seeking routing strategies by allowing for SDL interaction against resting visible liquidity, subject to certain limits.

The new optional SDL functionality will be referred to as ‘SDL Plus’.<sup>1</sup>

**Details and Rationale**

Currently, users are able to specify two different options for IOCs/FOKs marked SDL – the first allowing for execution against dark price improving liquidity only, and the second allowing for the SDL to also execute against dark resting liquidity at the Protected NBBO, subject to the ‘large’ size requirements for at-the-quote dark executions.<sup>2</sup>

The SDL Plus feature will allow users to specify a third execution option for their SDL IOCs/FOKs that will cause the order to execute against resting price-improving dark liquidity followed by resting visible liquidity at the Protected NBBO from the same broker (attributed) until any volume allocated in the ‘broker preferencing’ priority tier has been exhausted (subject to the volume and price limit imposed on the SDL Plus order by the user).

The order type will be most beneficial for those currently using cross-seeking routing strategies in that it will allow the user the ability to oversize their orders to maximize the amount of price-improving dark liquidity captured.

Additional details are as follows:

- The execution price of an SDL Plus order will be constrained to the less aggressive of the order’s limit price or the opposite-side Protected NBBO, and regardless of any OPR instruction included on the SDL Plus order.

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<sup>1</sup> TSX has filed a patent application for SDL Plus.

<sup>2</sup> See UMIR 6.6.

SDL Plus orders with limit prices that are more aggressive than the opposite side NBBO, and SDL Plus market priced orders, will be automatically repriced to the opposite side NBBO.

- SDL Plus orders must be broker attributed in order to execute against resting visible volume in the broker preferencing priority tier. An SDL Plus order that is marked as anonymous will be accepted, but will behave like an SDL order that has been specified to only interact with price-improving dark liquidity.
- An attributed SDL Plus order will execute against visible attributed same-broker volume at the Protected NBBO, subject to the order's limit price.
- Once any visible attributed same-broker volume participating in the broker preferencing allocation tier is exhausted, any remaining portion of the SDL Plus order will cancel back to the participant.
- If there is no visible same-broker attributed volume at the opposite-side Protected NBBO on TSX, an SDL Plus order will behave like an SDL order that has been specified to only interact with price-improving dark liquidity.
- SDL Plus orders entered with a 'bypass' instruction will be rejected, as is currently applicable for SDL orders.
- RT participation is not applicable when an SDL Plus order executes against visible resting volume in the broker preferencing tier.

As is applicable for current SDL functionality, SDL Plus users will be able to apply the Minimum Quantity (MinQty) restriction that requires a minimum volume threshold be met for the IOC/FOK to trade. The Minimum Interaction Size (MIS) feature will not be available for SDL Plus. Information on MinQty functionality is available in TSX's Dark Liquidity Guide.<sup>3</sup>

Examples of SDL Plus functionality are provided in Appendix A to this notice.

#### **Expected Date of Implementation**

The proposed changes are expected to become effective in Q3 2019 at the earliest.

#### **Expected Impact**

TSX believes the SDL Plus feature will provide users with additional means to maximize their interaction against dark price-improving volume resting on TSX via a variety of active routing strategies. These include cross-seeking routing strategies employed by various participants today, whereby they seek to trade against their own visible resting orders.

By using the SDL Plus feature, it also provides opportunities for dealers to maximize the volume filled against their clients' orders resting on TSX, reducing information leakage where it allows for the order to be fully satisfied.

#### *Impact in the context of internalization*

We appreciate that some may view the SDL Plus feature as facilitating an increase in broker preferencing in Canada, and thereby helping to promote internalization. We also acknowledge that increased internalization has been and continues to be a topic of debate amongst industry participants. TMX held an industry roundtable discussion on internalization in January 2018,<sup>4</sup> and a concept paper from the Canadian Securities Administrators to further explore the topic has recently been published for comment.

We had withheld formally proposing this feature in light of industry concerns related to internalization and uncertainties as to what direction the awaited concept paper would take. We have chosen now to proceed with proposing this feature for the following reasons:

- there is continued direct customer demand for the feature, and supported by increased adoption of cross-seeking routing strategies;
- market-wide attributed unintentional cross rates have continued to rise unabated, driven by the introduction of broker preferencing on a competing market; and

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<sup>3</sup> Available at: <https://www.tsx.com/resource/en/1764/dark-liquidity-guide-v1.pdf>.

<sup>4</sup> [https://www.osc.gov.on.ca/documents/en/Securities-Category2/sn\\_20171205\\_23-319\\_internalization-in-the-canadian-market.pdf](https://www.osc.gov.on.ca/documents/en/Securities-Category2/sn_20171205_23-319_internalization-in-the-canadian-market.pdf).

- the introduction of SDL Plus will not necessarily increase market-wide ‘internalization’ rates<sup>5</sup> further, and may actually help to reduce those rates.

Regarding the last of the above points, our expectation is that primary use of SDL Plus will be by those already using cross-seeking active routing strategies. In that case, we would expect use of SDL Plus to shift such activities away from other markets to TSX resulting in no overall net change to market-wide ‘internalization’ rates. To the extent that SDL Plus is successful at providing price-improving dark volume to those strategies, this could also have the effect of reducing market-wide internalization rates by shifting traded volume from what otherwise is occurring through a broker-preferenced trade on other markets to volume that trades against price-improving ‘any-broker’ dark resting volume on TSX.

#### **Expected Impact of Proposed Changes on the Exchange’s Compliance with Ontario Securities Law**

The proposed changes will not impact TSX’s compliance with Ontario securities law and in particular the requirements for fair access and maintenance of fair and orderly markets. TSX will continue to apply appropriate execution logic to ensure conformance with dark price improvement requirements under section 6.6 of UMIR.

#### **Estimated Time Required by Members and Service Vendors to Modify Their Own Systems after Implementation of the Proposed Amendments**

SDL functionality currently exists on TSX. Implementation effort for users is negligible as it will involve specification of one additional tag value for SDL orders to identify it as being SDL Plus. Usage is also optional.

Based on current planned implementation timelines, we anticipate that at least 90 days will be provided between regulatory approval and implementation, which should be sufficient to allow adoption by those that wish to take advantage of the SDL Plus order feature.

#### **Do the Changes Currently Exist in Other Markets or Jurisdictions**

As indicated above, SDL functionality exists today on TSX. Various participants also employ cross-seeking routing strategies through which they seek to trade against their own visible resting orders. SDL Plus will allow participants using these strategies to increase the amount of dark price-improving liquidity that can be captured in the process.

In technical terms, SDL Plus simply represents a limit or condition on an existing IOC/FOK (in addition to the order’s limit price and volume) that defines the point in the normal execution path at which the IOC/FOK is to stop. An SDL Plus will execute against resting dark volume following normal dark priority allocation rules on TSX, and will continue to execute against visible volume where current priority allocation logic allocates volume from the same broker first (both sides must be broker attributed). The SDL Plus order establishes a condition that halts the execution of the IOC/FOK after the end of the broker preferencing allocation tier, assuming that the IOC/FOK’s price and volume limits have not already been breached.

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<sup>5</sup> As measured by market-wide attributed unintentional cross rates.

## APPENDIX A

## EXAMPLES INVOLVING SDL PLUS ORDERS

The following examples demonstrate the proposed functionality for CMO orders.

Example 1: Execution of SDL Plus against visible volume.

Book as follows:

	Order Ref #	Lit / Dark	Public Broker #	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Dark	1	10:00:01	2,000	10.025	
TSX	2	Dark	1	10:00:07	1,000	10.01	
TSX	3	Visible	29	10:00:05	400	10.00	
TSX	4	Visible	6	10:00:06	500	10.00	

Action: Order #5 received – An IOC sell marked SDL Plus for 5,000 shares at \$10.00 is entered by Broker 6.

Result: Order #5 will trade 2,000 shares against Order #1 at \$10.025, 1,000 shares against Order #2 at \$10.01, and 500 shares against Order #4 at \$10.00 via broker preferencing allocation tier, and will then cancel back remainder of 1,500 shares at end of broker preferencing allocation tier.

Example 2: Normal broker preferencing rules apply.

Book as follows:

	Order Ref #	Lit / Dark	Public Broker #	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Dark	1	10:00:01	2,000	10.025	
TSX	2	Dark	1	10:00:07	1,000	10.01	
TSX	3	Visible	29	10:00:05	400	10.00	
TSX	4	Visible	6	10:00:06	500	10.00	

Action: Order #5 received – An IOC sell marked SDL Plus for 5,000 shares at \$10.00 is entered by Broker 1 (underlying broker is Broker 6).

Result: Order #5 will trade 2,000 shares against Order #1 at \$10.025, 1,000 shares against Order #2 at \$10.01, and will cancel back 2,000. There will be no trade against visible order #4 in the broker preferencing allocation tier as both sides are not publicly attributed to Broker 6.

Example 3: TSX Best Bid is worse than the Protected National Best Bid

Book as follows:

	Order Ref #	Lit / Dark	Public Broker #	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Dark	1	10:00:01	2,000	10.025	
TSX	2	Dark	1	10:00:07	1,000	10.00	
TSX	3	Visible	51	10:00:07	1,000	9.99	
TSX	4	Visible	6	10:00:08	500	9.99	

**SROs, Marketplaces, Clearing Agencies and Trade Repositories**

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Action: Order #5 received – An IOC sell marked SDL Plus 7,000 shares at \$9.99 is entered by Broker 6.

Result: Order #5 will trade 2,000 shares against Order #1 at \$10.025, and will cancel back 5,000. There will be no trade against Order #2, as the best visible bid on TSX is worse than the PNBB so the SDL Plus order will only interact with resting price improving dark orders. There will be no trade against Orders #3 and #4 for the same reason.