

Chapter 13

SROs, Marketplaces, Clearing Agencies and Trade Repositories

13.2 Marketplaces

13.2.1 TSX Inc. – Enhancements to Dark Trading Functionality – Notice of Proposed Changes and Request for Comment

TSX INC.

NOTICE OF PROPOSED CHANGES AND REQUEST FOR COMMENTS

ENHANCEMENTS TO DARK TRADING FUNCTIONALITY

TSX Inc. (“TSX”) is publishing this Notice of Proposed Changes 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 December 29, 2017 to:

Carina Kwan
Legal Counsel, Regulatory Affairs
TMX Group
The Exchange Tower
130 King Street West
Toronto, Ontario M5X 1J2
Email: 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

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 seeking to introduce further enhancements to its current dark trading functionality by adding a new midpoint pegged order type that will allow users to specify that the order is executable only against other similarly designated dark midpoint pegged orders.

The new order type will be referred to as the Contra Midpoint Only (CMO) order.

Details and Rationale

The CMO order will allow users to simulate the functionality of a dark midpoint match facility by limiting interactions to orders that want to trade at the midpoint, but only with other orders that have the same objective. The CMO provides users with an alternative to midpoint match functionality available on standalone dark markets.

The CMO order will function in the same way as TSX’s current Midpoint pegged order, except as outlined below:

- CMO orders will only execute against other CMO orders.

All attributes and features, such as the Minimum Quantity (MinQty), Minimum Interaction Size (MIS) and Post Only features, are eligible for use on a CMO order. They will function in the same way as when used currently on a Midpoint pegged order, except that these features are only applied when determining the potential for a match between two CMO orders. Information on these attributes and features is available in TSX's Dark Liquidity Guide.¹

CMO orders will only trade at the midpoint of the protected NBBO. Priority allocation for CMO orders will follow standard TSX priority for dark orders at the same price level – being broker, then time.

The matching of two CMO orders will occur irrespective of any non-CMO dark orders resting on the TSX order book at a better price, or at the same price (i.e., midpoint) with higher time priority. As indicated earlier, one of the intended objectives of the CMO order is to allow participants to simulate the functionality of a dark midpoint match facility – the bypassing of other resting dark orders on TSX produces a similar result for those orders as if the midpoint match occurred on a standalone venue, and arises by virtue of the choices of venue and order conditions applied by all parties involved. Further, we note that the potential for a trade at the midpoint on TSX that bypasses other resting dark liquidity could arise today depending on conditions imposed on the orders. (See Examples 4 and 4.1 in Appendix A to this notice for an example of a CMO trade that bypasses other dark resting liquidity, along with a comparable outcome involving an incoming non-CMO Midpoint order.)

TSX will have the ability to specify a minimum size restriction applicable to the entry of CMO orders (for example, 5 boardlots). The purpose of this would be to promote larger size executions and reduce potential for information leakage by requiring some level of commitment greater than a single boardlot. TSX may choose to initially set the minimum size restriction at 1 boardlot to allow TSX the ability to assess the need for the restriction based on CMO usage and experience. This would also allow more flexibility to users, while still providing them with the ability to seek size and manage any information leakage concerns through use of the MinQty and MIS features. Additional specifics relating to the minimum size restriction are as follows:

- Any CMO order that does not meet the minimum size upon entry will be rejected.
- Any CFO instruction to reduce a CMO order to a volume below the minimum size requirement will be rejected.
- A CMO order that has had its volume traded down to below the minimum size requirement will be eligible to be / remain booked and tradeable.
- Any minimum size restriction imposed by TSX, or changes thereto, will be made public via notice from TSX.

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

Expected Date of Implementation

The proposed changes are expected to become effective in Q2 2018.

Expected Impact

TSX is enhancing its current dark trading functionality to offer additional means of trading dark on TSX. TSX believes the CMO will provide an alternative to mid-point match functionality on standalone dark markets without the added burden, complexity and costs for industry associated with an additional (new) trading venue.

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 Changes

The midpoint peg functionality of the CMO order exists today on a variety of Canadian markets, including TSX and TSXV. Implementation for users will involve specification of a new pegged order value to identify the order as a CMO. Users will also need to ensure the size of the CMO meets any specified minimum size requirement imposed by TSX.

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

¹ Available at: <https://www.tsx.com/resource/en/3/dark-liquidity-guide-2017-09-20-en.pdf>.

Do the Changes Currently Exist in Other Markets or Jurisdictions

As indicated above, the midpoint peg functionality of the CMO order exists today on a variety of Canadian markets, including TSX and TSXV. The CMO introduces a new pegged order type that limits the circumstances in which it will trade against a contra-side order. Applying conditions like this are not uncommon for dark orders – for example, both the MinQty and MIS features on TSX and TSXV (and the comparable features on other Canadian marketplaces such as MATCHNow and Nasdaq CXC) represent conditions that limit execution based on the nature or characteristics of the contra-side orders.

Nasdaq (US) has proposed to implement a Midpoint Extended Life Order (M-ELO) which includes a similar midpoint-only functionality but combines the feature with a delay mechanism.²

² See SEC File No. SR-NASDAQ-2017-074 for public filings related to Nasdaq's proposed M-ELO order.

APPENDIX A

EXAMPLES INVOLVING CONTRA MIDPOINT ONLY ORDER

The following examples demonstrate the proposed functionality for CMO orders.

Example 1: Requirement for both sides to be CMO for match to occur, otherwise resting CMO can be bypassed

Book as follows:

	Order Ref #	BID order type	Lit / Dark	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	CMO	Dark	10:00:01	5,500	10.025	
TSX	2	Midpoint (non-CMO)	Dark	10:00:07	1,000	10.025	
TSX	3	Limit	Visible	10:00:03	2,000	10.00	

Action: Order #4 received – A sell visible limit order for 2,000 shares at \$10.00.

Result: Order #4 will trade 1,000 shares against Order #2 at the midpoint (\$10.025) and 1,000 shares against booked visible limit Order #3 at \$10.00 on the basis that the better-priced resting CMO buy order will only interact with another CMO order.

Example 2: Matching of two CMO orders

Book as follows:

	Order Ref #	BID order type	Lit / Dark	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	CMO	Dark	10:00:01	5,500	10.025	
TSX	2	Midpoint (non-CMO)	Dark	10:00:07	1,000	10.025	
TSX	3	Limit	Visible	10:00:03	2,000	10.00	

Action: Order #4 received – A sell CMO order for 2,000 shares.

Result: Order #4 will trade 2,000 shares against Order #1 at the midpoint (\$10.025) on the basis that both orders are CMO orders and are otherwise eligible.

Example 3: Execution at midpoint involving incoming non-CMO Midpoint order

Book as follows:

	Order Ref #	BID order type	Lit / Dark	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Limit	Dark	10:00:05	1,000	10.03	
TSX	2	CMO	Dark	10:00:01	5,500	10.025	
TSX	3	Midpoint (non-CMO)	Dark	10:00:07	2,000	10.025	

Action: Order #4 received – A sell non-CMO Midpoint order for 4,000 shares marked IOC.

Result: Order #4 will trade 1,000 shares against Order #1 at the midpoint (\$10.025) as is currently applicable for the execution of an incoming Midpoint order against a better-priced contra dark limit, and will trade 2,000 shares against Order #3 at the midpoint (\$10.025), bypassing CMO Order #2. CMO Order #2 does not receive a fill because the incoming sell Midpoint order is not similarly marked CMO. The 1,000 shares remaining for Order #4 is cancelled back as it was marked IOC and cannot trade against Order #2.

Example 4: Execution at midpoint involving two CMO orders, with bypassing of other resting dark orders

Book as follows:

	Order Ref #	BID order type	Lit / Dark	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Limit	Dark	10:00:05	1,000	10.03	
TSX	2	Midpoint (non-CMO)	Dark	10:00:02	2,000	10.025	
TSX	3	CMO	Dark	10:00:09	5,500	10.025	

Action: Order #4 received – A sell CMO order for 4,000 shares marked IOC.

Result: Order #4 will trade 4,000 shares against Order #3 at the midpoint (\$10.025), on the basis that Order #4 will only interact with a contra-side CMO order. Orders #1 and #2 are bypassed despite being better priced and/or having better time priority, by virtue of being non-CMO. (Note: Order #1 is only executable against an incoming Midpoint order at the midpoint.)

Example 4.1: Similar outcome as Example 4 by virtue of other order conditions

Book as follows:

	Order Ref #	BID order type	Lit / Dark	Timestamp	Volume	BID	ASK
<i>PNBBO</i>						10.00	10.05
TSX	1	Limit	Dark	10:00:05	1,000	10.03	
TSX	2	Midpoint (non-CMO)	Dark	10:00:02	2,000	10.025	
TSX	3	Midpoint (non-CMO)	Dark	10:00:09	5,500	10.025	

Action: Order #4 received – A sell non-CMO Midpoint order for 4,000 shares with MIS of 2,500 shares.

Result: Order #4 will trade 4,000 shares against Order #3 at the midpoint (\$10.025), on the basis that Orders #1 and #2 did not meet or exceed the MIS condition of 2,500 shares, despite being better priced and/or having better time priority. (Note: Order #1 is only executable against an incoming Midpoint order at the midpoint.)