

13.2.2 Liquidnet Canada – Targeted Invitation Functionality – Notice of Proposed Changes and Request for Comment

LIQUIDNET CANADA

NOTICE OF PROPOSED CHANGES AND REQUEST FOR COMMENT

Liquidnet Canada is publishing this Notice of Proposed Changes in accordance with the “Process for the Review and Approval of the Information Contained in Form 21-101F2 and the Exhibits Thereto.” Market participants are invited to provide the Commission with comment on the proposed changes.

Comment on the proposed changes should be in writing and submitted by September 19, 2016 to

Market Regulation Branch
Ontario Securities Commission
22nd Floor
20 Queen Street West
Toronto, ON M5H 3S8
Fax: (416) 595-8940
marketregulation@osc.gov.on.ca

and

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Comments received will be made public on the OSC website. Upon completion of the Review by OSC staff, and in the absence of any regulatory concerns, notice will be published to confirm the completion of Commission staff’s review and to outline the intended implementation date of the changes.

Any questions regarding the information below should be addressed to:

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Liquidnet Canada proposes to introduce the following change to the Liquidnet Canada trading system:

1. Targeted invitation functionality for trading of foreign debt securities

A. Description of the proposed change

Liquidnet Canada ATS is proposing to provide Canadian institutional clients with access to targeted invitation functionality for trading of non-Canadian fixed income securities (also referred to as “bonds”) on the fixed income trading systems operated by affiliates Liquidnet, Inc. (LNUS) and Liquidnet Europe Limited (LNEL).

Background

On July 28, 2015, Liquidnet Canada was granted an exemption from Section 6.3 of National Instrument 21-101 *Marketplace Operation* permitting Canadian subscribers (referred to as “Members”) to trade non-Canadian fixed income securities via trading systems operated by foreign affiliates LNI and LNEL.

The Liquidnet trading system provides both lit order book and negotiation functionality for trading non-Canadian fixed income securities. The fixed income negotiation functionality is based on indications (not firm orders) sent by Members to the Liquidnet Canada ATS, which are then routed to the indication matching engine operated by affiliates LNI and LNEL. When a Member has an indication that is transmitted to the indication matching engine, and there is another

Member with a matching indication on the opposite side on the same bond (a “contra”), Liquidnet notifies the first Member and any contra. Upon receipt of notification of a match, the two matching Members are in the one-to-one matching stage, where they may negotiate a price for the trade.

Overview of the proposed targeted invitation functionality

As an extension of its existing negotiation functionality, LNI and LNEL have implemented targeted invitation functionality for fixed income securities for Members located in the US and Europe. Liquidnet Canada wishes to enable Canadian Members to participate in this functionality, as described more fully below.

When a match is unavailable, targeted invitations will allow Members to selectively widen their search for trading opportunities by sending invitations concerning particular bonds or groups of bonds to other Members who previously had the opposite-side indication in the Liquidnet fixed income trading system within a Member-specified look-back period. All Members who upgrade to a version of the Liquidnet software that is compatible with the targeted invitation functionality, and, in the case of Canadian Members, affirmatively opt-in to participate in this functionality, will be eligible and enabled to send and receive targeted invitations. Upon request by a Member at any time, Liquidnet will disable the Member from participating in targeted invitation functionality. Since targeted invitation notifications are objectively limited to Members who have demonstrated contra-interest during a defined look-back period, information leakage, and associated market impact, is minimized.

While additional detail concerning the proposed functionality is provided below, we wish to highlight the following important characteristics of a targeted invitation:

- A targeted invitation for a fixed income security does not represent a firm order.
- A targeted invitation is only displayed to one recipient at a time.
- If a recipient accepts a targeted invitation, the sender and recipient can engage in the normal negotiation process – just as they would for any other match in the system.

Parameters for a targeted invitation

When sending a targeted invitation, a trader must specify the following parameters:

- **Look-back period.** A targeted invitation is only sent to a trader who had an opposite-side indication in Liquidnet during the look-back period. A trader can select the current trading day as the look-back period or the current trading day plus any of the following periods: 1, 3, 5, 10, 20, 50, 100 or 200 prior trading days.
- **Max recipients.** The maximum number of traders who can receive the targeted invitation.
- **Minutes in force.** The number of minutes for which the targeted invitation will be active. The system cancels all targeted invitations at the end of Liquidnet’s trading day for the applicable region and instrument.
- **Priority.** Whether to prioritize recipients based on “most recent” or “size”.

Liquidnet applies a set of default parameters, but a trader can modify any of the defaults for any targeted invitation.

Information provided to the sender of a targeted invitation

A sender is not notified whether a targeted invitation has been received by another trader. If a recipient accepts the sender’s targeted invitation, as described below, the sender receives notification of a match. The match notification to the sender indicates that the recipient has accepted the sender’s targeted invitation.

A sender is also notified when a recipient elects “interested but need ten minutes” (as described below).

Qualifying recipients of targeted invitations

A qualifying recipient is any trader who had an opposite-side indication to the sender’s indication at any time during the look-back period specified by the sender, subject to the following additional conditions being met:

- The recipient is logged in
- The recipient’s indication size meets the sender’s minimum size

- The sender's indication size meet the recipient's minimum size
- The recipient is enabled for targeted invitations.

If a qualifying recipient of a targeted invitation is involved in a match, the system will not send a targeted invitation to the recipient.

As noted above, a targeted invitation is only sent to one contra at a time. When there are multiple qualifying recipients for a targeted invitation, prioritization depends upon the search priority parameter selected by the sender.

Actions upon receipt of a targeted invitation

Upon receipt of a targeted invitation, a trader has up to five minutes to select a response from one of the following:

- **Accept invitation.** This creates an indication in Liquidnet for the applicable bond and direction (for example, buy indication if the sender has a sell indication, and sell indication if the sender has a buy indication). When selecting this option, the recipient must specify the size for his or her indication.
- **Interested but need ten minutes.** This provides the trader additional time to decide whether or not to accept the invitation. If a trader specifies this response, the trader's response time is extended to ten minutes from when the trader makes this election. During this ten-minute period, the trader can still select any of the other three responses in this sub-section. The sender of the targeted invitation will be notified that the recipient (without disclosing the recipient's identity) has selected this option.
- **Not interested for now.** If a trader specifies this response, the system will no longer display the targeted invitation to the trader, but the trader can continue to receive other targeted invitations in that bond.
- **Don't show me TIs in this bond again.** If a trader specifies this response, the system will no longer display the targeted invitation to the trader, and the trader will not receive any targeted invitations in that bond (direction specific) unless, in the future, the trader enters an indication in that bond and direction at Liquidnet.

If a trader receiving a targeted invitation has not selected one of the options above within the five-minute period (or the trader has selected the "interested but need ten minutes" response within the five-minute period and has not selected one of the remaining three options above within the ten-minute period), the system notifies the trader that the targeted invitation is no longer available and makes the following options available to the trader:

- **Create indication.** This creates an indication in Liquidnet that is opposite-side to the sender's indication.
- **Create indication plus targeted invitation.** This creates an indication in Liquidnet that is opposite-side to the sender's indication and also a targeted invitation at the same time. This option is not available if the trader has elected for the system to automatically send indications (i) immediately when an indication is sent into Liquidnet or (ii) at a specified number of minutes after an indication is sent to Liquidnet.
- **Not interested for now.** If a trader specifies this response, the system will no longer display the targeted invitation to the trader, but the trader can continue to receive other targeted invitations in that bond.
- **Don't show me TIs in this bond again.** If a trader specifies this response, the trader will not receive any targeted invitation in that bond (direction specific) unless, in the future, the trader enters an indication in that bond and direction at Liquidnet.

Expiration of a targeted invitation to a recipient

A targeted invitation to a recipient expires upon the earliest of the following:

- The recipient's acceptance of the targeted invitation
- The recipient responding that it is not interested for now or don't show TIs in this bond again
- The expiration of the five or ten-minute response period, as applicable
- Cancellation of the targeted invitation by the sender or deletion of the relevant indication from the sender's blotter.

Upon expiration of a targeted invitation to a recipient other than as a result of the recipient's acceptance of the targeted invitation, the system will send a targeted invitation to the qualifying recipient, if any, who is next in priority, unless the sender at that time has a match in Liquidnet in the applicable indication or the minutes in force of the targeted invitation have expired.

Termination of match

If a match between the sender and recipient of a targeted invitation terminates, the system will send a targeted invitation to the qualifying recipient, if any, who is next in priority, unless the sender at that time has a match in Liquidnet in the applicable indication or the minutes in force of the targeted invitation have expired.

Amending a targeted invitation

A trader can edit or cancel a targeted invitation at any time through the Liquidnet client software. If a trader changes the parameters of a targeted invitation, the new parameters become applicable.

Acceptance of a targeted invitation does not guarantee a match

It is possible that between the sending of a targeted invitation and acceptance by the recipient, the sender has matched with another contra-side indication (an "existing match"). This existing match would be the result of an opposite-side indication being received by Liquidnet between the sending of the targeted invitation and acceptance of the targeted invitation by the recipient. In this scenario, the trader accepting the targeted invitation will not see a match until the existing match terminates. Upon termination of the existing match, the system will prioritize the recipient against other same-side matches based on Liquidnet's rules of priority in cases of multiple contras.

Cancellation of a targeted invitation by sender

At any point in time the sender of the targeted invitation can cancel the targeted invitation, delete the relevant indication, or move the relevant indication into an "out of pool" state. In any of these scenarios, the recipient of the targeted invitation will receive a notification that the targeted invitation is no longer available. The recipient of the targeted invitation will then receive a notification which includes the option to create an indication or a targeted invitation for the relevant bond and direction.

B. The expected date of implementation

It is expected that the proposed change will be implemented shortly after satisfaction of the requirements set forth in Section 3.2(1) of National Instrument 21-101, *Marketplace Operation* (NI 21-101), including the expiration of a 45-day notice period.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed functionality to provide Canadian participants with the ability to draw otherwise latent liquidity to the marketplace, while still minimizing information leakage. The proposed functionality has already proven successful in the US market, and Liquidnet Canada respectfully submits that Canadian participants are currently at a disadvantage without it.

D. Expected impact of the proposed change on market structure, subscribers, investors and capital markets

We foresee no adverse impact on market structure, subscribers, investors or the capital markets because the proposed change will only help participants draw otherwise latent liquidity in non-Canadian fixed income securities to the marketplace.

E. Expected impact of the proposed change on Liquidnet Canada's compliance with Ontario securities law and the requirements for fair access and maintenance of a fair and orderly market

We foresee no adverse impact on Liquidnet Canada's compliance with market structure, Ontario securities laws or to requirements of fair access and the maintenance of a fair and orderly market.

F. Consultations undertaken in formulating the proposed change, including internal governance process followed

Liquidnet Canada consulted with certain customers before proceeding with the proposed change. The proposed change was approved by the management of Liquidnet Canada.

G. Whether the proposed change will require subscribers and vendors to modify their own systems

The proposed change will not require any work by subscribers or vendors to modify their own systems. The proposed change is not a material change to technology requirements regarding interfacing with or accessing the marketplace within the meaning of Part 12.3 of NI 21-101.

H. Whether the proposed change would introduce a fee model or feature that currently exists in other markets or jurisdictions

Liquidnet Canada's affiliates in other jurisdictions have already implemented the proposed functionality in other markets.