

13.2.2 Liquidnet Canada, Inc. – Notice of Proposed Changes and Request for Comment – Changes to the Liquidnet Canada Trading System



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LIQUIDNET CANADA

NOTICE OF PROPOSED CHANGES AND REQUEST FOR COMMENT

CHANGES TO THE LIQUIDNET CANADA TRADING SYSTEM

Liquidnet Canada has announced plans to implement the changes described below within 30 days after approval. Liquidnet Canada 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 21-101F2 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 November 24, 2014 to

Market Regulation Branch
Ontario Securities Commission
Suite 1903, Box 55
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.

Liquidnet Canada has announced plans to implement the changes described below within 30 days after approval.

Any questions regarding the information below should be addressed to:

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Liquidnet Canada proposes to introduce the following five (5) changes to the Liquidnet Canada trading system:

1. Indications manually added to the pool will default to “active” status

A. Description of change

In current versions of the Liquidnet software, including Liquidnet 3X and the current version of Liquidnet 5, a trader can manually change the status of an indication from “outside” status, i.e., ineligible for matching, to “passive” status or from “outside” status to “active” status. In the proposed new version of Liquidnet 5, a trader will be able to manually change the status of an indication from outside to active, but will no longer be able to change the status of an indication from outside directly to passive. In other words, indications manually added to the pool will default to “active” status because the trader’s affirmative action indicates a willingness to trade and signals that active, as opposed to passive, status is appropriate.

Transmission of indications

Members can interact with Liquidnet Canada by transmitting non-binding indications. Indications are non-binding, which means that a further affirmative action must be taken by the trader before an executed trade can occur.

Members transmit indications from their order management system (OMS) to Liquidnet and manage those indications through the Liquidnet desktop application, which is installed at one or more trader desktops at the Member firm. Indications can be transmitted through a periodic sweep, FIX transmission or other method agreed among Liquidnet, the Member and the Member’s OMS vendor, as applicable.

Matching of indications

Negotiation functionality for Canadian equities is provided through the Liquidnet Canada ATS. For Members that elect to participate in Liquidnet’s negotiation functionality, Liquidnet the broker transmits indications received from the Member to Liquidnet’s indication matching engine. When a trader at a Member firm (a “trader”) has an indication in Liquidnet that is transmitted to Liquidnet’s indication matching engine, and there is at least one other trader with a matching indication on the opposite side (a “contra-party” or “contra”), Liquidnet notifies the first trader and any contra. A matching indication (or “match”) is one that is in the same equity and instrument type and where both the trader and the contra are within each other’s minimum tolerance quantities.

Starting a negotiation; sending an invitation

When Liquidnet notifies a trader of one or more active contras for a security (see discussion below), the trader can start a negotiation for that security by selecting a contra, specifying a price and negotiation quantity, and submitting a bid or offer. This is also known as “sending an invitation.” When a trader sends an invitation in response to an active indication, he is making a firm bid or offer. A trader can only send an invitation on any match to one contra at a time. If a trader sends an invitation when the status of his or her indication is passive, the status of the trader’s indication is converted to active. A trader can only send an invitation to a contra that is active.

Negotiation process

Liquidnet negotiations are anonymous one-to-one negotiations through which traders submit bids and offers to each other. The first bid or offer in a negotiation is submitted when one trader opens the negotiation room and sends an invitation. Subsequent bids and offers may be submitted as counter-bids or counter-offers in the negotiation. “Bids and offers” are sometimes referred to as “proposals”. An invitation is a type of proposal. An execution occurs when one trader’s proposal is accepted by the contra.

Active, passive and outside status

A trader may set an indication to “outside,” which makes the indication ineligible for Liquidnet’s indication matching engine. Indications that are eligible for Liquidnet’s indication matching engine are considered “in the pool.”

An indication that is in the pool can have a status of passive or active. Unless otherwise configured for a trader, all indications have an initial default status of passive. A trader can indicate that he is ready to receive an invitation to negotiate by changing the status of his indication from passive to active. This is also known as “going active.” The indication that is made active is known as an “active indication.” The active status is displayed to the contras on a match. Going active is not a binding bid or offer.

In current versions of the Liquidnet software, including Liquidnet 3X and the current version of Liquidnet 5, a trader can manually change the status of an indication from outside to passive or from outside to active. Should the proposed change be implemented, in Liquidnet 5, a trader will be able to manually change the status of an indication from outside (not eligible for matching) to active (eligible for matching), but will no longer be able to change the status of an indication directly from outside to passive. A trader will still be able to change the status of an indication from active to passive.

B. Expected date of implementation

Liquidnet Canada plans to implement the proposed change within 30 days after receipt of regulatory approval.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed change to promote matching situations where both parties have an intention to trade. A trader who manually changes the status of an indication (previously “outside”) to add it to the pool and make the indication eligible for matching with a contra is indicating a willingness to trade, so active status, as opposed to passive status, is appropriate.

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 should only promote matching situations where both parties have an intention to trade.

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

The proposed change will not require subscribers or vendors to modify their own systems.

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

The proposed change will likely be implemented by Liquidnet in other non-Canadian jurisdictions prior to the expected implementation of this feature in Canada.

2. Indications ineligible to trade default to “outside” status

A. Description of change

Liquidnet Canada proposes to make available to Members various configuration rules that default specific types of indications to “outside” status, i.e., ineligible for matching. These rules can include, for example, defaulting to outside:

- indications with market-on-open instructions;
- indications with market-on-close instructions; or
- indications that are part of a portfolio or program list.
- Transmission of indications

Members can interact with Liquidnet Canada by transmitting non-binding indications. Indications are non-binding, which means that a further affirmative action must be taken by the trader before an executed trade can occur.

Members transmit indications from their order management system (OMS) to Liquidnet and manage those indications through the Liquidnet desktop application, which is installed at one or more trader desktops at the Member firm. Indications can be transmitted through a periodic sweep, FIX transmission or other method agreed among Liquidnet, the Member and the Member’s OMS vendor, as applicable.

Matching of indications

Negotiation functionality for Canadian equities is provided through the Liquidnet Canada ATS. For Members that elect to participate in Liquidnet's negotiation functionality, Liquidnet the broker transmits indications received from the Member to Liquidnet's indication matching engine. When a trader at a Member firm (a "trader") has an indication in Liquidnet that is transmitted to Liquidnet's indication matching engine, and there is at least one other trader with a matching indication on the opposite side (a "contra-party" or "contra"), Liquidnet notifies the first trader and any contra. A matching indication (or "match") is one that is in the same equity and instrument type and where both the trader and the contra are within each other's minimum tolerance quantities.

Active, passive and outside status

A trader may set an indication to "outside," which makes the indication ineligible for Liquidnet's indication matching engine. Indications that are eligible for Liquidnet's indication matching engine are considered "in the pool."

An indication that is in the pool can have a status of passive or active. Unless otherwise configured for a trader, all indications have an initial default status of passive. A trader can indicate that he is ready to receive an invitation to negotiate by changing the status of his indication from passive to active. This is also known as "going active." The indication that is made active is known as an "active indication." The active status is displayed to the contras on a match. Going active is not a binding bid or offer.

Should the proposed change be implemented, Liquidnet Canada will make available to Members various configuration rules that default specific types of indications to "outside" status, i.e., ineligible for matching. These rules can include, for example, defaulting to outside indications with market-on-open instructions; indications with market-on-close instructions; or indications that are part of a portfolio or program list.

B. Expected date of implementation

Liquidnet Canada plans to implement the proposed change within 30 days after receipt of regulatory approval.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed change to promote matching situations where both parties have an intention to trade by allowing Members to default to outside status indications that they do not intend to trade through Liquidnet.

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 should only promote matching situations where both parties have an intention to trade.

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

The proposed change will not require subscribers or vendors to modify their own systems.

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

The proposed change will likely be implemented by Liquidnet in other non-Canadian jurisdictions prior to the expected implementation of this feature in Canada.

3. Automatic conversion of indications to “outside” status

A. Description of change

Liquidnet Canada proposes to automatically convert the status of a trader’s indication from passive to outside, if a trader with a match does not take a positive action within five minutes after being alerted through the System that the contra on the match has gone active. Positive action, for this purpose, means sending an invitation to negotiate or creating an algo order.

Transmission of indications

Members can interact with Liquidnet Canada by transmitting non-binding indications. Indications are non-binding, which means that a further affirmative action must be taken by the trader before an executed trade can occur.

Members transmit indications from their order management system (OMS) to Liquidnet and manage those indications through the Liquidnet desktop application, which is installed at one or more trader desktops at the Member firm. Indications can be transmitted through a periodic sweep, FIX transmission or other method agreed among Liquidnet, the Member and the Member’s OMS vendor, as applicable.

Matching of indications

Negotiation functionality for Canadian equities is provided through the Liquidnet Canada ATS. For Members that elect to participate in Liquidnet’s negotiation functionality, Liquidnet the broker transmits indications received from the Member to Liquidnet’s indication matching engine. When a trader at a Member firm (a “trader”) has an indication in Liquidnet that is transmitted to Liquidnet’s indication matching engine, and there is at least one other trader with a matching indication on the opposite side (a “contra-party” or “contra”), Liquidnet notifies the first trader and any contra. A matching indication (or “match”) is one that is in the same equity and instrument type and where both the trader and the contra are within each other’s minimum tolerance quantities.

Active, passive and outside status

A trader may set an indication to “outside,” which makes the indication ineligible for Liquidnet’s indication matching engine. Indications that are eligible for Liquidnet’s indication matching engine are considered “in the pool.”

An indication that is in the pool can have a status of passive or active. Unless otherwise configured for a trader, all indications have an initial default status of passive. A trader can indicate that he is ready to receive an invitation to negotiate by changing the status of his indication from passive to active. This is also known as “going active.” The indication that is made active is known as an “active indication.” The active status is displayed to the contras on a match. Going active is not a binding bid or offer.

Should the proposed change be implemented, Liquidnet Canada will automatically convert the status of a trader’s indication from passive to outside, if a trader with a match does not take a positive action within five minutes after being alerted through the System that the contra on the match has gone active. Positive action, for this purpose, means sending an invitation to negotiate or creating an algo order.

B. Expected date of implementation

Liquidnet Canada plans to implement the proposed change within 30 days after receipt of regulatory approval.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed change to promote matching situations where both parties have an intention to trade. If a trader does not take a positive action within five minutes after being alerted that the contra on the other side has gone active, it makes sense to automatically move the indication outside because it is likely that the trader is not interested or available to move forward with a trade at that time.

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 should only enhance the trading experience and reduce frustration for traders at Member firms.

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 market structure, subscribers, investors or the capital markets because the proposed change should promote matching situations where both parties have an intention to trade.

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

The proposed change will not require subscribers or vendors to modify their own systems.

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

The proposed change will likely be implemented by Liquidnet in other non-Canadian jurisdictions prior to the expected implementation of this feature in Canada.

4. Removing restriction to allow liquidity partners (LPs) to submit directed orders

A. Description of change

"Liquidity partners" (LPs) are brokers that transmit immediate-or-cancel (IOC) orders to Liquidnet's H2O functionality for execution. Liquidnet H2O is functionality that is part of the Liquidnet Canada ATS. Liquidnet H2O provides for the automated execution of non-displayed orders at the mid-point of the CBBO. One category of participant in Liquidnet H2O is liquidity partners (also referred to as "LPs"). LPs do not have access to the Liquidnet desktop application and do not interact with the Liquidnet negotiation functionality.

Liquidnet Canada plans to remove the following conditions for LP orders:

- LP orders must access Liquidnet H2O through a smart order router; and
- Customers of Liquidnet's LPs are not permitted to preference or designate Liquidnet as the execution venue for an order.

Once these restrictions are removed, LPs without smart order routers will be able to send IOC orders to Liquidnet H2O for execution.

B. Expected date of implementation

Liquidnet Canada plans to implement the proposed change within 30 days after receipt of regulatory approval.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed change in an effort to facilitate interaction with brokers who do not employ smart order router technology, while also providing additional liquidity for Member firms.

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 should only enhance the trading experience for traders at Member firms and provide additional opportunities for new brokers to participate as liquidity partners.

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

The proposed change will not require subscribers or vendors to modify their own systems.

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

The proposed change to remove certain conditions for LP orders has previously been implemented by Liquidnet in other non-Canadian jurisdictions.

5. Addition of closing price negotiation proposals

A. Description of change

Liquidnet Canada plans to introduce a third type of negotiation proposal: closing price.

Liquidnet Canada currently permits two types of negotiation proposals: priced and mid-peg. A priced proposal has an associated price displayed to the contra and can only be executed at the indicated price. A mid-peg proposal does not have an associated price. A mid-peg proposal, if accepted, is executed at the mid-price at the time of execution.

The proposed closing price proposal, if accepted, will be executed at the closing price for the stock. The closing price for a stock is determined by reference to the applicable market data feed sourced by Liquidnet Canada, the TMX-IP. A closing price proposal cannot be executed if the execution price is more than 1.5% away from the mid-point as of the time of execution or if the closing price is outside the CBBO as of the time of execution.

Prior to the open of trading in a country, and during the regular trading session in the primary market of the country, only priced and mid-peg proposals can be submitted during a negotiation. After the close of the regular trading session in the primary market of the country, only closing price proposals can be submitted.

B. Expected date of implementation

Liquidnet Canada plans to implement the proposed change within 30 days after receipt of regulatory approval.

C. Rationale for the proposed change

Liquidnet Canada is implementing the proposed change in an effort to provide enhanced trading functionality for traders at Member firms.

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 add additional trading functionality for traders at Member firms.

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 markets

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

The proposed change will not require subscribers or vendors to modify their own systems.

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

The proposed change to add closing price negotiation proposals has previously been implemented by Liquidnet in other non-Canadian jurisdictions.