

**Liquidnet Canada Inc.**  
**Notice of Proposed Change and Request for Comments**

OSC staff (**staff** or **we**) are publishing today a Notice of Proposed Change and Request for Comment (**Notice**) from Liquidnet Canada Inc. (**Liquidnet**) which relates to the proposed introduction of a trading functionality that would allow Liquidnet's marketplace participants to send and receive targeted invitations to trade (**proposed functionality**). While staff seek comment on all aspects of the proposed functionality, we are also seeking answers on a number of specific questions, set out below.

**Overview of the proposed functionality**

The proposed functionality is described in detail in the Notice. We have also included a high-level summary below in order to provide context for the request for comments.

Liquidnet's proposed functionality would enable a marketplace participant that is an institutional investor (**buy-side participant**) to send an invitation to trade a block-sized quantity to one or more buy-side participants. The sender of the invitation must specify, among others, the total execution size, the minimum execution size it is willing to accept, a limit price and time in force. The recipient receives a targeted invitation indicating that there is a buyer or seller for a particular security. Trades are executed at mid-point. The minimum execution size for the targeted invitations proposed by Liquidnet is the lesser of 25,000 shares and 15% of the average daily traded volume for a particular security.

While the sender specifies the number of intended recipients for the invitation, the actual recipients of a targeted invitation are selected by Liquidnet based on their past trading history and demonstrated interest in trading a specific security.

The recipient of an invitation, if interested, may choose to negotiate on the size further or may execute the order at the minimum size specified by the sender.

**Staff request for specific comments**

Staff review any proposal filed with the OSC in the context of the principles and objectives of the current regulatory framework and, more broadly, the OSC's statutory mandate. With respect to new, or changes to, a marketplace's proposed trading functionality, staff give consideration to their impact on the following characteristics of an efficient and effective market:<sup>1</sup>

1. Market liquidity
2. Transparency and price discovery

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<sup>1</sup> These characteristics were outlined in Joint CSA/IROC Consultation Paper 23-404 *Dark Pools, Dark Orders and Other Developments in market Structure in Canada*, and are based on the TMX's (then, TSE) 1997 *Report of the Special Committee on Market Fragmentation: Responding to the Challenge*.

3. Fairness
4. Market integrity

1. *Liquidity*

Liquidnet submitted that the proposed functionality would have a positive impact on liquidity, as it would allow a marketplace participant to solicit trading interest, which may result in a trade, when there is no liquidity otherwise available on Liquidnet's market.

2. *Transparency and price discovery*

National Instrument 21-101 *Marketplace Operation (NI 21-101)* sets out the pre- and post-trade transparency requirements for equity securities.<sup>2</sup> The purpose of these transparency requirements is to ensure that investors have information to be able to make informed trading decisions. No pre-trade transparency is required by NI 21-101 if order information is only displayed to a marketplace's employees or persons or companies retained by the marketplace to assist in the operation of the marketplace.<sup>3</sup> This exception allows for the operation of marketplaces without pre-trade transparency (dark pools), in recognition of the value they bring by facilitating the execution of large orders with limited market impact costs.<sup>4</sup>

While a marketplace may broadcast indications of interest to attract interest in the pool, the Companion Policy to NI 21-101 indicates that, when an indication of interest contains sufficient information to be executed without further discussion between two parties (it is "actionable"), it is a firm order and the pre-trade transparency requirements of NI 21-101 would apply.<sup>5</sup> The purpose of this provision is to ensure that, when marketplaces show information to more than just their employees or persons or companies retained by the marketplaces to assist in their operation, they provide the same information to all participants.

Under the proposed functionality, the targeted invitations would contain sufficient information to allow them to be traded without further negotiation, which means that they are actionable and, in effect, firm orders. As indicated above, they would be subject to the pre-trade transparency requirements in NI 21-101. However, Liquidnet does not propose that information in the targeted invitations be subject to pre-trade transparency because doing so would likely result in increased market impact costs as the target invitations are for block-sized orders and would likely deter buy-side participants from sending the invitations.

Staff request specific comment on the following:

***Question 1: Should Liquidnet receive an exemption from the pre-trade transparency requirements in NI 21-101 for block-sized orders? Should the exemption be***

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<sup>2</sup> Sections 7.1 and 7.2 of NI 21-101.

<sup>3</sup> Subsection 7.1(2) of NI 21-101.

<sup>4</sup> Market impact costs occur when the execution of an order moves the price of that security above the target price for a buy order or below the target price for a sell order. When information is leaked about a large order before it is executed, these costs can increase significantly.

<sup>5</sup> Subsection 5.1(3) of 21-101CP.

*limited to orders of buy-side participants? Are there other conditions that should apply?*

**Question 2:** *If Liquidnet is granted an exemption from pre-trade transparency is the lesser of 25,000 shares and 15% of the average daily value the appropriate size?*

### 3. Fairness

NI 21-101 has the fair access requirements applicable to all marketplaces. It requires, among others, that a marketplace not permit unreasonable discrimination among clients, issuers and marketplace participants.<sup>6</sup>

As described in the Notice, buy-side participants that choose to participate in the proposed functionality are eligible to receive targeted invitations based on criteria developed by Liquidnet which are based on data reflecting their liquidity and trading history for a specific security in the previous two quarters. Staff question whether the proposal is consistent with the fair access provisions of NI 21-101 and request specific comment on this issue.

**Question 3:** *Is Liquidnet's proposed functionality consistent with the application of the fair access requirements of NI 21-101?*

### 4. Market integrity

Market integrity relates to the level of general confidence investors and the general public have in the entire market or in a particular marketplace. The proposed functionality may protect buy-side participants from negative market impact costs that would arise from steep price movements associated with the trade of a block-sized order.

## Submission of comments

Comments on the Notice should be in writing and submitted by December 26, 2016 to:

Market Regulation Branch  
Ontario Securities Commission  
20 Queen St. West, 22<sup>nd</sup> Floor  
Toronto, ON  
M5H 3S9  
[marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

and to:

Mr. Thomas Scully  
General Counsel  
Liquidnet Canada Inc.  
498 Seventh Avenue

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<sup>6</sup> Section 5.1 of NI 21-101.

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