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VIA EMAIL

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Re: TSX Inc. Notice of Proposed Amendments and Request for Comment – Enhancement of "Seek Dark Liquidity" Functionality ("Notice")

Dear Ms. Tikhomirova:

Nasdaq CXC Limited ("Nasdaq Canada" or "we") welcomes the opportunity to provide comments on the TSX proposal to create an "Internalization Order" in violation of Canada's fair access regime. Specifically, the proposal would enable users of the current Seek Dark Liquidity Order to execute against resting visible liquidity at the Protected NBBO from the same broker, cancelling back any volume exceeding what is available to be internalized ("SDL Plus" or the "TSX Proposal").

While Nasdaq generally refrains from commenting on competing markets' proposals, we strongly oppose the SDL Plus on three bases: (1) it violates Canada's fair access regime, 2) it circumvents the restrictions placed on dealers operating systems that internalize order flow in National Instrument 21-101 ("NI 21-101") and (3) by expanding the internalization tools available today, it will result in increased internalizing rates at a time when marketplace features and dealer practices facilitating internalization are under regulatory review. Although TSX characterizes the SDL Plus as an additional option for current SDL users, in reality the new functionality combines an SDL Order (which has been approved and is supported by other marketplaces) with an Internalization Order that restricts access to the dealer entering the order making it inaccessible to other participants.

The OSC is not simply reviewing the SDL Plus functionality but instead is being asked to set a new and harmful precedent for a stand-alone internalization order. If approved, other marketplaces will be free to introduce internalization orders that do not necessarily have to interact with dark liquidity first. They will be free to support internalization orders that are only eligible to execute against displayed orders from the same dealer, cancelling back any unexecuted shares.

SDL Plus Violates Canada's Fair Access Regime

The SDL Plus functionality violates Canada's fair access regime. Counterparty selection is not permitted under Canada's application of fair access in order to ensure that orders are available to trade against orders from other participants. The SDL Plus functionality violates this principle by enabling dealers to effectively select themselves as the only eligible counterparty against which to trade. This is a significant deviation from Canada's equity market structure today. Whereas broker preferencing provides priority execution for orders from the same dealer, the SDL Plus in addition to providing priority also restricts access to these orders from all other participants. Any residual shares that have not been internalized are cancelled back to the dealer instead of becoming available to trade against other participants' orders. Where sufficient liquidity exists on the book to fully execute and order, the SDL Plus prevents an otherwise available execution. Not only does this rob resting orders from other participants of an execution, but it also robs the active order from receiving a complete fill. Of particular concern is when an active SDL Plus order is entered for a client and an execution opportunity is missed as a result of a dealer prioritizing internalization. This feature of the SDL will either create challenges or will facilitate violations of dealer's best execution obligation.

SDL Plus Circumvents NI 21-101

The SDL Plus circumvents the prohibition on dealers using systems that match buy and sell orders without providing open access (among other requirements) to other participants in NI 21-101. The definition of a marketplace in NI 21-101 includes "a dealer that executes a trade of an exchange-traded security outside of a marketplace."[1] Guidance in CP 21-101 provides that "a dealer that uses a system to match buy and sell orders or pair orders with contra-side orders outside of a marketplace and routes the matched or paired orders to a marketplace as a cross may be considered to be operating a marketplace."[2] A dealer system caught under this definition is required to comply with all marketplace rules including fair access and will be forced to open up access to its order flow to all participants. The SDL Plus effectively results in the same outcome prohibited under NI 21-101. Instead of a dealer system being used to match buy and sell orders that are unavailable to other participants off marketplace that are then routed to a marketplace, in the context of the SDL Plus the TSX is providing the system. Whether or not orders are matched and then printed or printed when matched, creating silos of liquidity inaccessible to other participants is contrary to fair access, NI 21-101 and negative for the health of the overall market.

SDL Plus will Increase Internalization Rates when Internalization is Under Regulatory Review

If approved, the introduction of the SDL Plus will increase internalization rates at a time when marketplace features and dealer practices that facilitate internalization are under regulatory review because of industry and regulatory concerns about an increase in the use of these practices.

In the TSX Notice the TSX acknowledges there are industry concerns related to internalization and that there is currently an ongoing regulatory review being performed. Three explanations are provided to justify the TSX Proposal despite the current environment:

[1] Section 1.1 of NI 21-101.
[2] Subsection 2.1(8) of Companion Policy 21-101CP.

- there is continued direct customer demand for the feature, and supported by increased adoption of cross seeking routing strategies;

There will always be demand for marketplace features that facilitate internalization possibilities by dealers because of the benefits of internalization for dealers (cost, execution etc.). However, to justify the TSX Proposal based on the increased adoption of cross seeking strategies which benefit from the use of broker preferencing fails to recognize that broker preferencing does not benefit all customers equally, and that increased levels of internalization resulting from these strategies negatively impact the health of the overall market.

- market-wide attributed unintentional cross rates have continued to rise unabated, driven by the introduction of broker preferencing on a competing market;

This claim is speculative in nature and needs to be substantiated. It is true that CXC Trading Book (CXC) was the last lit market to introduce broker preferencing in August 2018. However, before this time internalization still occurred on CXC – it was simply not as easily identifiable. Before broker preferencing was introduced all orders on the CXC were anonymous.

- the introduction of SDL Plus will not necessarily increase market-wide 'internalization' rates further, and may actually help to reduce those rates

The TSX explains this view based on the expectation that the primary users of the SDL Plus will be those already using cross-seeking active routing strategies and that these strategies will shift from away markets to TSX resulting in no overall net change to market-wide internalization rates. We disagree. Dealers that use cross seeking active routing strategies already use these strategies on the TSX to displace attributed resting orders. Given that any residual shares of an SDL Plus order will be cancelled back, users will still be incentivized to seek crosses on other venues to maximize internalization opportunities. Second, users that send orders with the exact size intended to match with the size of a resting order of the same dealer may have these orders unintentionally interact with other participant orders as a result of the resting order no longer being available when the active order arrives. By the TSX trading system enforcing internalization and cancelling back any residual size the SDL Plus eliminates this possibility. Third, only a subset of dealers have access to the technology required to executes cross seeking active routing strategies today. The SDL will make these strategies available to participants that do not currently employ these strategies thus increasing the level of market wide internalization rates.

We strongly encourage the OSC to disapprove the TSX Proposal because it will establish a precedent for a stand-alone internalization order. If approved, other marketplaces will be able to introduce internalization orders where orders will only be eligible to match against attributed orders from the same dealer with any residual shares being cancelled back. This is dangerous precedent that will prove to deteriorate the quality of Canada's equity market and represents a significant deviation away from the on exchange internalization facilitated by broker preferencing.

We thank the OSC for the opportunity to provide comments and would welcome the opportunity to discuss further our views with staff.

Sincerely,

Nasdaq Canada