June 16, 2025

Submitted via E-Mail

<u>Attention:</u>

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Dear Dear Sirs/Mesdames:

RE: NASDAQ CXC LIMITED – PROPOSED CHANGE – NOTICE AND REQUEST FOR COMMENT

The Canadian Forum for Financial Markets (CFFiM), formerly the Investment Industry Association of Canada (IIAC), welcomes the opportunity to comment on the Ontario Securities Commission's Notice and Proposed Changes (the "**Request for Comments**") to expand the eligible orders that a Midpoint Extended Life Order ("**M-ELO**") can execute against to include certain Mid-Peg orders ("**MPEG**") in Nasdaq CXC Limited's CXC Trading Book (the "**Proposed Change**"). All capitalized terms that are not otherwise defined in this letter are defined in the Request for Comments.

<u>OVERVIEW</u>

The Proposed Change and the process by which it has been developed raise the following concerns:

1. The Proposed Change continues a trend of piecemeal regulatory efforts to increase the competitiveness of dark pool orders, which may come at the expense of the competitiveness of the central limit order book ("**CLOB**") and contribute to fragmentation.

2. The Request for Comments is devoid of any supporting data or a cost-benefit analysis on the Proposed Change. In particular, the Request for Comments lacks any data related to the reduced risk of latency that is referenced in support of the Proposed Change.

3. In response to the consultation questions and based on the information included in the Request for Comments, ex poste trading adjustments may create perverse incentives that are detrimental to the markets and the information advantages created by the Proposed Change could have unfair results.

The Request for Comments should have included all of the relevant data and the parallel proposal to amend the CXC Trading Book to, among other things, remove certain liquidity seeking orders. This would have allowed for a complete review of the Proposed Change within the context of a larger set of dark pool amendments. The piecemeal approach that has been taken to these amendments and the fundamental lack of supporting data has undermined the public consultation process by impairing substantive feedback on the Proposed Change.

The continued fragmentation of the price discovery process and vertical integration should not continue without proper cost-benefit analyses on the impact of this fragmentation on the competitiveness of Canada's markets. Any further consideration of the Proposed Change should be postponed pending the production of supporting data and the republication of the Request for Comments.

COMMENT ON PROPOSED CHANGE

Risk of Fragmentation

M-ELO orders were originally approved as a fully dark and submerged order type.

The principle in the marketplace prior to this point was that to get the benefit of broker-priority, the broker had to advertise their quote and be willing to give up some information to "get something in return". M-ELO orders were approved as a type of anonymous order based on the understanding that these orders were only matched against orders of the same type, which effectively synthesized the "block" requirements. However, according to the Request for Comments, M-ELO orders will be extended to MPEG orders (which are time priority matching only). The Request for Comments ignores the controversies associated with anonymous order types and continues a trend of proposals, which reduce incentives to display on the CLOB. We are concerned that the Request for Comments is silent on the negative impact that anonymity can have on markets in favour of its Proposed Change.

Although the Request for Comments acknowledges that Canadian equity market is fragmented, the general trend towards disincentivizing CLOB participation will only serve to increase market fragmentation.

Risk of Fragmentation

The Request for Comments does not provide any data in support of the Proposed Change. In particular, the Request for Comments does not include any data on:

- the number of M-ELO orders and fills each day;
- how the number of M-ELO orders and fills compare to daily CXC orders and fills; and
- how the number of M-ELO orders and fills compare to daily MPEG orders and fills.

In the absence of any of the above data, it is impossible to evaluate the potential costs and benefits of the Proposed Change.

With respect to the potential benefits of the Proposed Change, the Request for Comments notes that the Proposed Change will "increase member execution rates and improved trading performance". However, it is not possible to evaluate whether the Proposed Change will have a material impact on trading without supporting data. More generally, it is unclear whether and to what extent the Proposed Change will benefit NASDAQ or the marketplaces as a whole.

The Request for Comments also states that, under the Proposal, "M-ELO orders will be able to source additional liquidity on CXC while continuing to mitigate against latency arbitrage opportunities and adverse selection". Again, it is not possible to consider and substantively respond to this purported benefit in the absence of supporting information on:

- The latency measurements for NASDAQ's outbound systems.
- Whether M-ELO and MPEG order types are completed on separate processors or in parallel on the same order book.
- Whether all co-located servers at NASDAQ are equidistant to the order books and details on whether the order books are equidistant to each other and/or the OE gateway.
- Information on whether there are any other latency drags between the OE and trading engine.
- Data on the expected latency of client order entry for M-ELO and MPEG orders.
- Data on the frequency of M-ELO and MPEG orders.

This lack of data also makes it difficult to evaluate the potential costs of the Proposed Change and how those costs will be borne by industry participants. In particular, it is unclear whether and to what extent the costs of incentivizing MPEG and M-ELO orders through the Proposed Change will be borne by other dark books and/or the CLOB. The potential costs of the Proposed Change are not limited to technology changes but may include additional training, education, and supervision. Moreover, in the absence of data, it is not possible to evaluate the more diffuse costs of this Proposed Change which may include reduced market transparency.

In the absence of data, the Request for Comments fails to contextualize the Proposed Change in terms of the anticipated costs and benefits and damages the public consultation process by making it not possible to fully respond to the Proposed Change.

RESPONSE TO CONSULTATION

Consultation Question No. 1: Fair Access

The Request for Comments poses the following question:

> How would the Proposed Change, which entails a passive Mid-Peg order paying trading fees or receiving a rebate depending on the type of the contra order it executes against, impact fair access to such participants?

The Proposed Change supports a pricing scheme that offers conditional pricing on the active side, which may result in lower fees or a rebate when they are filled depending on the order type against which they execute. However, this assumes that the only parties to the fee model are the active and passive participants at the singular trade level. Fees play a critical role in incentivization and in the overall information content of the market. Orderly markets demand transparency and ex poste fee adjustments are a step in the wrong direction.

The securities industry is based on the premise that marketplaces do not unreasonably prohibit, condition, or limit access to trading, and do not permit unreasonable discrimination among market participants. On a practical level this is achieved by affording all market participants a level of transparency and uniformity, which serves to generate predictability. Ideally, pricing models should be transparent and applied before the order is entered to create predictability and clarity on incentives and trading behaviours. All participants should not only know their own costs before the order is entered, but also the costs and incentives that other participants bear in their interactions.

The corollary is that complexity and any obfuscation of fees may reduce the willingness of participants to contribute quotes to price discovery and could harm the integrity or the marketplace by encouraging the deliberate use of fee differentiation to alter net spreads for different participants and in an unfair manner. The perils of ex poste fee adjustments are summarized below:

- **Transparency**: Applying rebates and discounts or changing allocations post-trade may change the competitiveness of this segment of the market as a priori incentives are hidden from the public view, making it harder to compete, and making the competition less willing at the margin to participate in price discovery.

- **Uniformity**: Not all participants can demand that their orders compete for these conditional incentives because not all end-client participants have the ability to direct their orders to all venues at their discretion. Not all trading costs are borne by a dealer prior to charging commissions. DEA clients who avail themselves of pass-thru billing which directly bears exchange fees may be presented with unique incentives from the incentive to utilize MPEG orders that may interact with M-ELO orders.

- **Predictability**: After trade fee adjustments may directly impact the integrity of the market for other order types that don't benefit from conditional pricing. Moreover, to the extent that two separate sets of flows can be predictably shaped (e.g., retail block flow and an electronic market makers flows in but one example) and directed to these pools, this could open a Pandora's box of "backdoor payment for order flow" or differential incentives to attract certain business to certain broker dealers.

Although it is unclear as to whether the Proposed Change will result in material changes to order quantities, we caution against conditional pricing schemes that may further erode transparency, uniform, and predictability. The Proposed Change may otherwise serve as a negative precedent for additional and more material ex poste pricing models.

Consultation Question No. 2: Informational Advantage

The Request for Comments poses the following question:

> Would the passive participant have an informational advantage over other market participants since they would have information about the type of contra order it executes against, which is not available to other market participants?

Based on the information provided in the Request for Comments, it would appear that passive participants could in fact gain an informational advantage over other market participants. In principle, an information advantage on a contra order coupled with an information advantage on your own trading costs, and an execution advantage in the form of anonymity risks unfair results. In the absence of any supporting data, it is impossible to assess the extent of this risk.

CONCLUSIONS

The Proposed Change should be postponed pending the production of supporting data and a complete cost benefit analysis and following the republication of the Request for Comments. Supporting data is required for market participants to understand the benefits of the Proposed Change including on liquidity and the avoidance of price arbitrage. In addition, data is required to evaluate the costs and impacts of the Proposed Change including the impact on incentivization and price discovery. This information will allow for a contextual and substantive review of the Proposed Change with proper consideration given to whether the Proposed Change improves the competitiveness of Canada's markets.

Respectfully submitted,

Canadian Forum for Financial Markets