CANADIAN SECURITY TRADERS ASSOCIATION, INC.
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Market Regulation Branch Ontario Securities Commission
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And:

Matt Thompson Chief Compliance Officer
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Re: Nasdaq CXC Limited – Notice of Proposed Changes and Request for Comment

The Canadian Security Traders Association, Inc. is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling and trading of securities (mainly equities). The CSTA represents over 850 members nationwide, and is led by Governors from each of four distinct regions (Toronto, Montreal, Prairies and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world.

This letter was prepared by CSTA representatives with various areas of market structure expertise. It is important to note that there was no survey sent to our members to determine popular opinion. The views and statements provided below do not necessarily reflect those of all CSTA members or of their employers.

The Canadian Security Traders Association appreciates the opportunity to comment on the proposed changes to the Nasdaq CXD book:

- Option 1 – Retail Orders: permits orders entered by all certified retail Trader IDs to trade regardless of the minimum size parameter;
- Option 2 – Member Retail: permits orders entered by certified retail Trader IDs of the Member to trade regardless of the minimum size parameter;

- Option 3 – Trusted Flow: permits all orders from the Member to trade regardless of the minimum size parameter.

The CSTA has historically opposed the practice of segmentation, including in our public comments to various marketplace proposals involving guaranteed-fill facilities for retail orders. We reiterate our historical view that the segmentation of retail flow away from the broader market will be damaging to overall market quality.

The following is direct quotation from Nasdaq's proposal:

"The Proposed Changes are being introduced to provide additional liquidity and price improvement opportunities than would otherwise be unavailable for eligible orders. The first option will permit all retail orders that do not meet the minimum size parameter to trade against a Minimum Size Order regardless of size. This option will provide institutional investors more opportunities to trade without the same level of concern of being adversely selected while providing price improvement or new opportunities for active Retail Orders."

Example 2: With new option (Option 1) – Incoming retail order

	PO #	BID	ASK	PO #
NBBO		10.10	10.12	
CXD Book	098	10.11 (MAQ)		
MAQ Minimum Size Constraint: (1000 shares)				

Action: A retail order is entered by Member 009 to sell 900 shares at the midpoint on CXD before it is sent as a limit order with a price of 10.10 to CX2.

Result: Although the 900 share order is below the 1,000 share MAQ minimum size parameter, the new option allows the order to trade against the Mid Peg MAQ order at the midpoint (10.11) on CXD. The order receives better execution because of the immediacy of execution at an improved price level ($0.01).

We agree the proposed changes will provide more opportunities for institutional investors to trade with active retail orders. We also agree that both orders in the above example benefit from the proposed discriminatory features of the new MAQ. However, providing exchange members the ability to selectively pull in certain segments of desirable trading counter-parties also comes with a cost; by skimming away the smallest, most desirable orders from the marketplace (i.e. active retail orders), the proposed MAQ functionality increases the average toxicity of the remaining order flow. The quoted spread and depth at the PNBBO are proportional to the average risk premium required to incentivize the provision of liquidity to everyone, including to retail investors. Removing the most desirable trading counter-party from the equation increases the average cost of liquidity provision for everyone else. Thus, the cost of option 1 is a reduction in the incentive to provide, deep, passive quotations at the PNBBO.

The following is direct quotation Nasdaq's proposal:

"The second option will permit retail orders from the same Member that do not meet the minimum size parameter to trade. This option is being introduced to provide Members another choice, particularly to address any expressed concerns by an institutional customer about the quality of retail order flow handled by other Members.

Option 3 will permit all orders from the same Member to be eligible to trade. Because Members are aware of the type of order flow they handle, they are positioned to assess the risk of adverse selection of their non-retail order flow."

More generally, the benefits of Option 1, 2 and 3 are narrow in scope and apply only to the orders and members at the time of the trade. The cost of Option 1, 2 and 3 is broad in scope, impacts everyone, and will result in a permanent increase in the risk premium, and hence the cost, associated with providing passive liquidity at the PNBBO. By selectively providing some client types the ability to trade while denying other client types the ability to trade, for an otherwise identical order, the exchange is facilitating an anti-competitive behavior and violating section 3a and 3b of the Fair Access requirements in NI 23-101.

The CSTA believes that the degree of discrimination offered by the proposed MAQ functionality described in option 1, 2 and 3 is unreasonable. Reasonable discrimination is already well embedded into our market structure, order handling and best execution practices. Transparent orders have priority over dark orders, large orders are subject to a different order exposure rule than small orders, market orders are routed differently than limit orders and orders that provide liquidity are charged different fees than orders that take liquidity. Such examples are all reasonable degrees of discrimination. In each case the discrimination is based upon the orders' characteristics. Unreasonable degrees of discrimination would include discrimination across client types or another inherent characteristic that is not possible to change. For example, one could choose to send a large order or a series of small orders. One could choose to either take liquidity or provide liquidity. One could choose to send a lit order or dark order. But one cannot choose the origin of their order or if the order originates from a retail client or a market-making client or from an insurance company or a pension fund. Such examples, while not exhaustive, are all examples of unreasonable discrimination practices because the client is not able to alter or change any of the key characteristics. Any protected marketplace ought to be free from unreasonable degrees of discrimination.

At its core, the Nasdaq CXC proposal illustrates an example of "the tragedy of the commons". The tragedy of the commons is a situation in a shared-resource system where individual users, acting independently according to their own self-interest, behave contrary to the common good of all users by depleting or spoiling the shared resource through their collective action. In a competitive marketplace, the shared resource is price discovery and market quality more generally. Individual investors, acting in their own self interest, may wish to segment their activity and even to select their own trading counter-party, but any gains from such counter-party selection also come at a cost to the overall marketplace.

The CSTA believes the proposed changes to the CXC book create an anti-competitive landscape by providing the exchange member with an unreasonable degree of discrimination when selecting their trading counter-party. Thus, the CTSA would question if the proposed changes are consistent with the fair access requirements laid out in NI 21-101 (see below).

> 5.1 Access Requirements
>
> > (3) A marketplace must not
> >
> > > (a) permit unreasonable discrimination among clients, issuers and marketplace participants, or

(b) impose any burden on competition that is not reasonably necessary and appropriate.

As noted by NASDAQ Canada in their filing "the CSA and the Investment Industry Regulatory Organization of Canada (IIROC) are reviewing the internalization rates in the Canadian equity market and are considering whether any additional regulatory action needs to be taken given existing rules and market structure." We would suggest that until that review is complete and the results can be analyzed and properly debated, that IIROC avoid approving new exchange facilities where the primary aim is to increase internalization in our marketplace, especially where the internalization mechanism allows an unreasonable degree of discrimination in selecting a trading counter-party.

We thank you for the opportunity to comment. Please feel free to contact Peggy Bowie, CSTA President at 416-903-3284 if you have any questions or wish to continue the discussion.

Best,

Stéphane Ouellette
Chair of the Canadian Security Traders Association

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Response to: https://www.osc.gov.on.ca/documents/en/Marketplaces/cxc_20200423_rfc-proposed-changes.pdf