RESHAPING CANADA'S EQUITIES TRADING LANDSCAPE

TMX | Toronto Stock Exchange | TSX Venture Exchange | Select | Alpha

CANADA'S MARKET. FOR ALL.

RESHAPING CANADA'S EQUITIES TRADING LANDSCAPE

As an intrinsic element of Canada's capital markets, TSX Equities embraces its role as Canada's national market operator. Through Toronto Stock Exchange (TSX), TSX Venture Exchange (TSXV), TMX Select and Alpha we provide marketplaces where all can trade with confidence and certainty. This is both a long-standing responsibility and a deeply ingrained aspect of our culture.

For over 160 years, we have been the champions of vibrant and enduring Canadian capital markets, working together with the industry to evolve and adapt, to enhance our collective position globally, and to respond to challenges and opportunities with solutions that address a broad range of client and investor needs.

Today, we again find ourselves at a point where industry challenges require decisive action to preserve the efficiency and integrity of our markets. There are three significant issues that require our attention and action:

- **Canadian order flow is migrating to the United States (U.S.)**
- **Technology-driven markets are not optimized to serve all**
- **Market complexity is on the rise**

We have examined each of these issues at great length and through extensive consultation with our clients and a broad group of other market participants. After careful analysis we are now proposing bold steps to tackle each one.

This document provides an overview of our proposed changes, which are subject to regulatory approval. In our view, each will have a beneficial and singularly significant impact on the market. Importantly, these initiatives are open for discussion and we encourage all market participants to carefully consider each and to share their views. To successfully reshape Canada's equities trading landscape for the benefit of all, the debate, collaboration and support must be open and expansive. We encourage and welcome your input.

Canadian order flow is migrating to the U.S.

THE ISSUE:

As Canadian capital markets become more fragmented and complex, retail and institutional investors and their agents continue to seek ways to improve quality of execution and reduce costs. Increasingly, they look beyond our national borders to do so.

In the U.S., market structure allows wholesalers and other intermediaries to offer attractive options to Canadian securities dealers. In return for the order flow of certain types of natural investors in the most active Canadian securities, dealers receive executions with more favourable economics.

However, the same model cannot be replicated in Canada within the existing regulatory framework including rules governing fair access, banning payment for order flow between dealers and setting minimum standards for price improvement when trading with dark orders.

As a result, some Canadian dealers are considering – or have already begun – changing their order routing practices to execute immediately tradable (active) Canadian retail and institutional flow with U.S. wholesalers, rather than on our domestic public markets. This movement of liquidity to the U.S. represents a serious risk to the quality and vibrancy of Canada's capital markets as a whole, and may have irreversible consequences.

OUR CHALLENGE:

Provide a market-driven, commercial solution within our regulatory framework that will retain order flow in Canada.

OUR RESPONSE:

Provide superior, domestic execution for active natural order flow.

In June 2015, we plan to introduce an innovative trading model on Alpha that will significantly improve the economics and quality of execution for active natural order flow, while improving trading conditions for liquidity providers willing to commit to a minimum order size.

The new Alpha model is built on the premise that most active institutional and retail order flow values certainty and size of execution over speed, and that dealers executing those orders seek to minimize trading costs while meeting best execution obligations.

The superior execution will be achieved by applying an order processing delay (a "speed bump") for orders that have the potential to remove liquidity from the order book, enforcing a minimum size for liquidity providing orders and providing rebates for active flow. [1]

Developed in the context of the Canadian regulatory framework and accessible on an equitable basis to all participants, this model will deliver improved economics for investors and dealers, and offer an attractive solution for the execution of active natural order flow in Canada.

[1] TSX has filed a patent application.

Delay Liquidity Taking Orders

A speed bump will be imposed on orders that have the potential to trade with passive liquidity – specifically, all orders not designated as Post Only. The speed bump will be applied equally to these orders of all participants – natural investors and others – and is expected to be set between 5 and 25 milliseconds.

Post Only liquidity providing orders will not be subject to a processing delay, allowing liquidity providers to effectively manage their risk.

The speed bump will discourage latency sensitive active strategies, but will not deter active natural order flow for which a delay in milliseconds is insignificant. This means that providers of passive liquidity will have an increased likelihood of interacting with active orders of natural investors, while being protected against opportunistic, latency sensitive active strategies.

Increased interaction with natural investors combined with the ability to bypass the speed bump when managing passive orders will encourage liquidity provision, better visible prices and an increase in displayed volume, resulting in better execution for natural order flow.

Minimum Size for Post Only Orders

In return for bypassing the speed bump, all Post Only orders will be subject to minimum size requirements.

The size threshold will ensure that liquidity providers post sufficient volume against which active orders can execute, contributing to higher average trade sizes, as well as improved fill quality and fill rates for natural active order flow. This, in turn, will minimize the signaling of liquidity bound for other markets and will reduce market impact.

Recognizing that securities exhibit a variety of liquidity profiles, the minimum volume requirement may differ across symbols.

Rebates for Active Orders

An inverted maker/taker fee model will provide a rebate for active orders, reducing trading fees for retail and institutional dealers and any other non-latency sensitive liquidity taking strategies.

SUMMARY OF BENEFITS

- High quality of execution for active order flow through increased fill certainty and sizes
- Lower trading costs for retail and institutional active order flow
- Larger displayed orders at more aggressive prices
- Attractive alternative to services offered by U.S. wholesalers

Technology-driven markets are not optimized to serve all

THE ISSUE:

Technological innovation has brought extraordinary changes to trading in capital markets around the world. These advancements have linked multiple global liquidity pools into a single virtual source of liquidity with unprecedented depth and resiliency. Barriers between countries, industries and asset classes have come down and investors today have access to an incredibly rich set of investment options at historically low costs.

As we embrace this change in technology-driven capital markets, it has become clear that in an environment where some participants increasingly compete on speed, others are challenged and concerned about compromised quality of execution and market integrity. Specifically, apprehensions around excessive short-term intermediation, the technology race to zero latency and the disenfranchising of the human trader have eroded some participants' confidence in a market that is meant to balance the needs of all stakeholders.

OUR CHALLENGE:

Preserve the benefits of technological advancements while empowering all to trade with confidence.

OUR RESPONSE:

Empower natural investors and other non-latency sensitive participants by rewarding committed liquidity.

In Q4 2015, TSX and TSXV plan to implement changes which will enhance the quality of execution for natural investors and their dealers – both retail and institutional – by rewarding those willing to commit liquidity to the book for a period of time by using the new Long Life[2] order type.

Long Life orders will be committed to a minimum resting time in the book – measured in seconds – and cannot be cancelled during that time. In return for providing committed liquidity, these orders will receive priority over orders at the same price that are not subject to the minimum resting time. Trade allocation therefore becomes Price/Broker/Long Life/Time rather than the current Price/Broker/Time matching sequence.

By choosing to use the Long Life order type, natural investors, their dealers and other non-latency sensitive participants will be able to more effectively and confidently participate in the markets without having to compete on speed.

SUMMARY OF BENEFITS

- Higher fill rates for natural passive order flow
- Higher fill rates for active orders due to greater reliability of the quote
- Less short-horizon fleeting liquidity, unnecessary intermediation and message traffic
- More interactions among natural investors' orders

[2] TSX has filed a patent application.

Market complexity is on the rise

THE ISSUE:

Advancements in technology and the development of new financial products are making markets more sophisticated and competitive. At the same time, traders are seeing more liquidity fragmentation and increased operational risks, costs and complexity.

In general, Canadian market participants are increasingly overwhelmed by the number of marketplaces and facilities that provide them with marginal value. The industry is burdened with excess costs, fragmentation and convoluted operations.

OUR CHALLENGE:

Reduce market complexity without sacrificing trading choice.

OUR RESPONSE:

Simplify and streamline market features and functionality while reducing fragmentation.

Through a series of initiatives, we will provide a streamlined approach to market structure that will effectively serve client needs while minimizing fragmentation and associated costs.

Reducing Fragmentation

We plan to close TMX Select and decommission Alpha IntraSpread in June 2015.

With this change, we will reduce complexity, fragmentation and dealer costs without compromising on choice. The mandate to provide a premium destination for active retail order flow, previously maintained by Alpha IntraSpread and TMX Select, will now be fulfilled by the new Alpha model.

Harmonizing Functionality

The following initiatives will streamline features across TSX, TSXV and Alpha:

- Eliminate the opening auction on Alpha for TSX- and TSXV-listed securities
- Execute odd-lots at the National Best Bid and Offer (NBBO) on each marketplace
- Implement common self-trade prevention and management features
- Upgrade Alpha to the TMX Quantum XA trading platform
- Extend continuous trading hours on Alpha
- Decommission the STAMP order entry protocol

SUMMARY OF BENEFITS

- Less operational complexity
- Lower dealer costs
- Improved user experience

Overview of TSX Equities marketplaces

DECEMBER 2015

TMX Toronto Stock Exchange / TSX Venture Exchange	TMX Alpha
VALUE PROPOSITION	
CANADA'S MARKETS FOR PRICE DISCOVERY AND BENCHMARK PRICING	PREMIUM DESTINATION FOR ACTIVE RETAIL AND INSTITUTIONAL ORDERS
PREFERRED POSTING DESTINATIONS FOR NATURAL INVESTORS	INCREASED FILL CERTAINTY AND SIZES FOR ACTIVE ORDER FLOW
HIGHER FILL RATES FOR NATURAL PASSIVE ORDER FLOW	LOWER TRADING COSTS FOR ACTIVE ORDER FLOW
GREATER RELIABILITY OF THE QUOTE	PROTECTION FOR PASSIVE LIQUIDITY
REDUCED INTERMEDIATION AND MESSAGE TRAFFIC	LARGER DISPLAYED ORDERS
MARKET MODEL	
OPENING AND CLOSING FACILITIES	NO OPENING OR CLOSING FACILITIES
MATCHING: PRICE/BROKER/LONG LIFE/TIME	MATCHING: PRICE/BROKER/TIME
ON-BOOK DARK LIQUIDITY	VISIBLE ORDER BOOK ONLY
LONG LIFE ORDER TYPE	ORDER PROCESSING DELAY ON ACTIVE ORDERS (ALL ORDERS EXCEPT POST ONLY ORDERS)
MARKET MAKING PROGRAM (TSX)	MINIMUM ORDER SIZE FOR POST ONLY ORDERS
ODD LOT DEALERS (TSXV)	INVERTED MAKER-TAKER PRICING (REBATES FOR ACTIVE ORDERS)
MAKER-TAKER AND SYMMETRICAL PRICING	EXTENDED CONTINUOUS TRADING HOURS
STANDARD TRADING HOURS	

COMMON FEATURES AND SERVICES

TMX QUANTUM XA TRADING PLATFORM

HARMONIZED ORDER TYPES AND FEATURES

SMART ORDER ROUTER

TMX RISK MANAGEMENT SERVICES

TMX CO-LOCATION FACILITY

SINGLE CUSTOMER SERVICE CENTRE

Express your views

The changes proposed in this document are subject to the required regulatory approval and public comment process. We have filed the Alpha amendments with regulators and expect these to be published for comment in early November, 2014. We invite you to take an active role in reviewing and commenting on these proposed changes and to make your voice heard.

TSX Equities will continue to initiate further industry conversations through advisory committees and one-on-one meetings. We will also solicit further input on the specifics of the proposals, including the length of the order processing delay for the Alpha speed bump, the duration of the Long Life order commitment and the impact of Long Life orders on the Market Making program.

We thank you in advance for working with us to finalize these changes. Only by working together can we reshape Canada's equities trading landscape to better serve the needs of all traders and investors.

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OCTOBER 2014

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