

Nasdaq Canada's Mellow Midpoint Order

Why Read This?

Nasdaq Canada's [proposed](#) Midpoint Extended Life Order (M-ELO) was [approved](#). We think it's worth a mention. We can also take the opportunity to mention a few other things that have happened.

Feature	Likely User	Importance	Novelty	Controversy
Midpoint Extended Life Order	Traders that don't like being run over	Medium	Medium	Low

Nasdaq's M-ELO order is in a close battle for the least-bad marketplace feature name with the current leader: "TSX DRK CMO+". For our take on who can name order types least-well, read below.

What Is It?

A well-understood issue with midpoint orders is the problem of adverse selection. If someone is going to impact the quote, they can ping midpoint venues for price improvement, before changing the midpoint to a worse price. If someone knows a quote has changed before a marketplace's matching engine, they can do the same. The loser in this equation is the resting midpoint order. This problem prompted some smart people to play with the length of fibre optics, and Michael Lewis wrote a book about those people.

There are alternatives to solving this problem without resorting to shoeboxes of fibre. The root issue is that active midpoint-pings can happen shortly before a marketplace's data feed reflects NBBO changes, and therefore the marketplace's engine has no chance to adapt. One solution, previously introduced in the U.S. by Nasdaq, is to ensure that liquidity-taking midpoint orders can't be too close in timing to active flow from a related source. In other words, you slow down midpoint activity to more tantric levels and prevent the resting midpoint order from being taken for a ride.

Nasdaq introduced the Midpoint Extended Life Order (M-ELO) in the U.S. in 2017 as an order for "counterparties with longer term investment horizons." We prefer to think of this as an order type for counterparties that don't like paying for adverse selection. Imitation is the sincerest form of flattery, and therefore the TSX is [launching](#) the very similar CMO+ on August 12th on the newly branded dark complex, "TSX DRK". Now, Nasdaq Canada is going head-to-head against the TSX in this feature category, lest the TSX usurp the good M-ELO name.

The M-ELO order works as follows:

- M-ELO orders trade only at midpoint (as the name would suggest).
- M-ELO orders can only trade with other M-ELO orders.
- M-ELO orders can only trade after they have been in the book for a minimum amount of time. Rest assured, this will likely be measured in milliseconds.

A trader entering a resting M-ELO order would be assured that the only execution can come from another order which is resting for a minimum amount of time – and therefore is not part of a sweep which is about to impact the NBBO. This is true as long as the minimum resting time is long enough; 5 microseconds is not enough, and 5 seconds is too long.

We note that this is entirely different from some other long life & delay-related features in Canada. The TSX Long Life Order provides queue priority in exchange for a time commitment to the book. The Alpha and NEO-N speedbumps offer similar protection only to participants fast enough to cancel their resting orders on their own.

Will It Work?

The concept being offered – all midpoint orders being committed to the book for a period of time – is a good one. The real question is one of adoption. There is increasing fragmentation in the midpoint arena:

- Dedicated marketplaces (MATCHNow, Nasdaq CXD, NEO-D, Instinet ICX)
- Midpoint orders on lit venues (including Nasdaq CXC and CX2, with which M-ELO would compete)

- Hybrid solutions such as TSX's upcoming CMO+.

M-ELO fits into the hybrid category. The challenge for adoption is that marketplace features that require extra work for dealers and vendors tend to be deprioritized in favour of other initiatives, such as customer service. As a result, it's entirely possible that adoption of M-ELO (and CMO+) will be [tectonic](#) until M-ELO activity prompts investment. This is a shame. We welcome competition based on features and not fee schedules.

Unfortunately, it's not all roses. It is likely that M-ELO orders will be identified as such on the public data feeds (similar to the [requirement](#) for CMO+, which is based on the original CMO being an isolated dark pool within an exchange). As this feature is targeting the institutional community, publicly identifying trades as "institutional" is a great way to create information leakage – and therefore a disincentive to use the facility in the first place. That would be a shame. We are generally for transparency, but one must remember that transparency comes at a cost to those being made transparent. Protecting the information of clients will trump the value-add of the order type, and may severely stunt the adoption of M-ELO (or CMO+).

We respectfully suggest that a more interesting (and controversial!) move would be for Nasdaq Canada to scrap its various midpoint alternatives on Nasdaq CXC, CX2 and CXD. Instead, a single midpoint facility that is entirely M-ELO would be a welcome improvement to the currently-fragmented status quo. Yes, this would limit interaction between active flow on Nasdaq and resting midpoint orders and hence reduce volume (which means Nasdaq would likely never do it). On the other hand, existing midpoint algorithms & connectivity can be re-used, users have to make fewer systems changes, and there are fewer hurdles to adoption. As part of this transformation, Nasdaq CXD could also be renamed to Nasdaq CXM-ELO.

As for the name? In the competition for this year's most lacklustre name for a marketplace feature, we favour M-ELO to TSX's TSX DRK CMO+. Why? We first pledge allegiance to Scotiabank's Head of Canadian Agency Trading, Jason Melo. Then we notice that a dash doesn't require pressing the "shift" key on our keyboard. Fewer typos, for the win!

In Other News...

Nasdaq's proposal for the order type claimed to offer a "unique" feature – broker priority available for both anonymous and attributed orders. This isn't particularly unique; MATCHNow has offered this feature for years. Unfortunately, this example of poor behaviour is being picked up by other marketplaces: NEO Exchange is [proposing](#) to add anonymous broker preferencing on NEO-D.

We scratch our heads at this practice, and in fact NEO's filing does point out that the organization has "*raised previously that we do not believe that a dealer should benefit from broker preferencing without disclosing its broker number, under general principles of fairness, and that the fact that there is no quantifiable harm because it is a dark pool should not be the deciding factor.*"

We fully agree. We therefore question why NEO Exchange is publicly turning around its position. We would have preferred that NEO's previously principled stance on this point remained in place – particularly as broker preferencing is in the spotlight as part of the CSA & IROC's public consultation on [internalization](#).

Word of the Day

[Tectonic](#) (adj.): Slow. Such as the movement of the Earth's [tectonic](#) plates.

Please do not hesitate to contact us if you have further questions.

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