



May 30, 2011

BY EMAIL

Secretary of the Commission
Ontario Securities Commission
20 Queen Street West
Toronto, ON M5H 3S8
Email: jstevenson@osc.gov.on.ca

Dear Mesdames/Sirs:

Re: Application for Recognition of Alpha Trading Systems Limited Partnership and Alpha Exchange Inc. as an Exchange

We appreciate this opportunity to comment on this application for recognition. We have responded to the ten specific questions published in the request for comments, and provided additional comments on key issues in the draft recognition order, proposed Listing Handbook, and proposed Trading Policies.

Background – CNSX Markets Inc.

CNSX Markets Inc. (“CNSX Markets”) is a recognized stock exchange in Ontario, and authorized or exempt in Quebec, British Columbia, Alberta and Manitoba. We operate two distinct markets: the Canadian National Stock Exchange and the Pure Trading (Pure) facility.

General Comments

We agree with Alpha’s general approach and support the idea of disclosure-based regulation by an exchange. We note, up front, that Alpha’s proposed regulation model is very similar to that developed and implemented by CNSX Markets (then CNQ) in 2003. The model has been proven, demonstrating that listed issuers can be effectively regulated by the combined efforts of the exchange and the securities commissions.

We are concerned, however, about fairness and competition among the exchanges. For example, Alpha has proposed a regulation model almost identical to that of CNSX Markets, while there is no mention in Alpha’s Listing Handbook or the draft recognition order of a requirement that a listing applicant be a reporting issuer in Canada to qualify for listing. This is an explicit requirement in the CNSX Markets recognition order and policies. The Commission would be creating an unlevel playing field unless either our requirements are removed or similar requirements are included in the Alpha Exchange recognition order and Listing Handbook.

Alpha has also proposed a governance structure that does not in our view adequately represent the diversity of all Alpha stakeholders, and should not be permitted to launch without changes to that structure.

Detailed comments on both of these issues can be found following our responses to the specific questions.

Specific Issues

Question 1: Is Alpha Group’s proposed governance structure, including its proposed role for a ROC, appropriate in the context of Alpha Group’s ownership structure and regulatory responsibilities? Does it adequately address the potential conflicts of interest? Alternatively, is requiring 50% independent representation on the Alpha Exchange board of directors appropriate? If so, would a ROC still be appropriate or necessary, and with what level of authority over regulatory matters?

In support of its proposed structure, Alpha refers to Ruben Lee’s *The Governance of Market Infrastructure*, in which Lee states “No one governance model is globally optimal for all market infrastructure institutions.” We agree.

With respect to fair representation of users in the governance system, Alpha provides a quote from the IOSCO *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, February 2008 (the “Principles”): “where applicable, a SRO should assure fair representation of members in selection of its directors and administration of its affairs.” Alpha further describes the importance of user representation on exchange boards, and the inclusion of specific principles in U.S. law, then asserts that since user directors will comprise fifty percent of the Exchange Board, the principle will be well reflected in the governance structure.

We note that the quote from IOSCO, which is part of a key question in assessing the implementation of the Principles, actually reads: “Where applicable, e.g., **a mutual organization**, assures a fair representation of members in selection of its board of directors and administration of its affairs?”¹ [emphasis added]. Alpha Exchange will not be a true SRO or a mutual organization, and the assertion that the Principles are met because “user directors will comprise fifty percent of the Exchange Board” is not consistent with the IOSCO Principles for the case where those directors are representing significant shareholders, rather than the general membership. As a result of the ownership structure and representation on the board, members that are not shareholders will not likely have representation on the board nor will users that are issuers (and not shareholders). Without specific criteria to ensure diversity on the board, the board will not be separated from the vested interests of its shareholders, bringing into question its ability to act in the public interest.

The appropriate minimum representation of independent directors on the board of a stock exchange in Canada has been established at 50%, consistent with the requirements of TMX Group and the recognition order for CNSX Markets. Alpha has proposed that the inclusion of a Regulatory Oversight Committee as part of the governance structure would suffice. CSA Notice 24-303 – CSA Oversight Project², however, includes the recommendation for 50% independent directors and a ROC. Regardless of our agreement with Ruben Lee’s observation, in general, this does not appear to be an appropriate case for allowing a different threshold for one exchange than that of the existing exchanges.

¹ IOSCO *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, February 2008, pg 34.

² CSA Notice 24-303 – CSA SRO Oversight Project – Review of Oversight of Self-Regulatory Organizations and Market Infrastructure Entities – Report of the CSA SRO Oversight Project Committee – December 2006, Part B – Governance.

Question 2: Is the definition of independence proposed by Alpha Group to be applied to Alpha Exchange's board [of] directors appropriate in the context and nature of their proposed structure? Are there any other exclusions that would be warranted?

The definition of independence is appropriate, including the provision that an owner that is not a member would be considered independent if the owner holds less than 10%. We also suggest that, given the very broad impact of the Alpha owners on the financial markets, any entity that receives significant compensation from not only Alpha Exchange, but also any of its owners should not be considered independent.

However, Alpha believes that the standards should be set by the Exchange Board rather than included in the recognition order because "it undermines the authority of the Exchange Board and creates inefficiencies by requiring amendments to the recognition order in case of change." We strongly disagree with Alpha's position. SROs and market infrastructure entities must have effective governance in order to allow the OSC to rely on them. Effective governance therefore is a pre-condition to recognition as a stock exchange, and should be addressed in the recognition order as a fundamental matter.

Question 3: Are the proposed terms and conditions of recognition that deal with conflicts of interest and confidentiality appropriate in light of the potential conflicts of interest associated with Alpha Exchange's ownership structure? If not, why not? Would other or additional terms and conditions be more appropriate?

The proposed terms and conditions are appropriate, including the requirement that the policies be publicly available on the Alpha website.

Question 4: Is it appropriate to impose a term and condition of recognition requiring Commission approval before a person or company obtains a certain percentage interest in Alpha Group, in order to consider the continued appropriateness of its ownership and governance structure? If so, what percentage of ownership is appropriate in the context of a privately-held exchange?

OSC Staff have proposed terms and conditions that would require prior approval from the Commission before any person or company could effectively own or control more than a certain percentage of Alpha LP, Alpha GP or Alpha Exchange. A threshold of 20% has been proposed. We do not believe such a condition would be necessary if an appropriate governance structure were to be required. Please see our responses to questions 1 and 2.

Question 5: Should issuers of the same size and quality be subject to an equivalent level of listed issuer regulation by competing exchanges? Are some elements of listed issuer regulation merely "branding" and if so, what are those areas?

The concept of issuer regulation encompasses a broad spectrum of requirements and standards. The mere existence of certain listing criteria or continued listing requirements appears to imply to many that one exchange may have more regulatory authority than another. It is therefore important that, for every exchange, the requirements to become and remain a listed company must be transparent. Investors should understand the role of the exchange in the affairs of the listed companies. Where a member of the CSA identifies a regulatory gap and seeks cooperation from exchanges, such cooperation should be required. It is a condition of recognition that rules

and policies foster investor protection and promote fair, efficient and competitive capital markets. Regulation by each exchange is necessary to ensure that listed companies meet the requirements of that exchange.

The existing requirements in securities law for reporting issuers are fundamental requirements that could be considered minimum standards. Certain requirements differ by issuer size and business. Certain regulatory requirements or listing criteria established by exchanges should be considered “branding”, such as:

- Disclosure requirements that exceed those set out in securities law and corporate law generally;
- Float requirements, including the number and percentage of freely trading shares, number of shareholders, and float value;
- Specific financial criteria, such as working capital, revenue, or net assets; and
- Corporate governance requirements that exceed those defined in corporate law or securities law.

Notwithstanding the competition between exchanges and the use of different listing requirements to define each exchange, requirements remain subject to review and approval by a CSA member. Thresholds or requirements that may give rise to a public interest concern would therefore be published for public comment and subsequent review and approval prior to implementation.

Question 6: Given the listing requirements proposed by Alpha Exchange, is it appropriate to classify tier 1 issuers as “non-venture” issuers and tier 2 issuers as “venture” issuers under applicable securities legislation? Should the CSA reconsider its current issuer “venture”/“non-venture” classification in light of the application by Alpha Exchange?

The classification of issuers and venture issuers under applicable securities legislation should not be based solely on the exchange but on the issuer, with consideration given to the reporting requirements of the exchange on which is listed. For example, an issuer listed on the TSX-Venture Exchange or CNSX that qualified for listing on the TSX but elected not to list there should be treated as an issuer, rather than a venture issuer.

This approach allows for exceptions, and more appropriately applies the classification based on the issuer itself, rather than the exchange. Changes to the listing requirements of the exchange would then have no impact on the classification of issuers.

We note that Alpha intends to add a character(s) to symbols to indicate tiers. We do not support the use of any marketplace-specific identifier within a symbol. This causes confusion among order entry and data vendors, inconvenience to traders, and is inconsistent with the existing requirements for identifiers.

Question 7: Is an exchange’s ability to exercise discretion necessary for regulating its listed issuers/ Or can shareholder approval and the role of independent directors be a substitute to ensure the maintenance of a quality marketplace?

With respect to listing, one of Alpha Exchange’s stated principles is: “*rejection of the exercise of discretion by the Exchange in the review of transactions. This approach was taken because it was reported that experience has shown that discretion is just as likely to be abused as exercised appropriately, and that the review by the exchange only added time and not necessarily value.*”

We developed and implemented a disclosure based approach in 2003. Further to our response to question 5 concerning regulation and branding, we are obviously supportive of a disclosure-based regulation model. However, discretion is an important aspect of regulation and by rejecting that discretion outright, it is unclear how Alpha intends to apply its rules and policies or exercise its authority as an exchange. It is clear Alpha will still exercise discretion when determining whether an applicant meets the listing criteria, or requests an exemption from a requirement. For example, in an excerpt from the Original Listing Requirements:

“2.01(2) Alpha considers a number of factors in exercising its discretion to list securities, and may refuse to list an issuer that otherwise meets the minimum standards set out below.”

There are many thresholds and standards throughout the Listing Handbook that will likely require some discretion on the part of the exchange. Any procedures for applying these standards with little or no discretion should be examined carefully to ensure the exchange is in a position to meet its mandate to act in the public interest.

Question 8: should a listed issuer that is an investment fund be subject to the same securityholder approval requirements for acquisitions as mutual funds? In particular, should the investment fund manager bear the costs and expenses associated with an acquisition of a listed issuer that is an investment fund?

We agree that the securityholder approval requirements should generally be the same, and that the fund manager should generally bear the costs and expenses.

Question 9: Should Alpha Exchange’s Listing Handbook contain specific criteria relating to listing applications from foreign special purpose issuers, such as investment funds or exchange-traded notes? Should this criteria require Alpha Exchange to consider Staff’s assessment that it would be in the public interest to approve such a listing application?

Our overall position, as presented in our general comments, is that given the similarities in the regulatory approach, foreign listed issuers should be considered in the same manner for Alpha as for CNSX Markets. Alpha should not be able to list them without them first becoming reporting issuers in a jurisdiction in Canada. Again, if OSC Staff have determined that such a restriction is no longer applicable, then it should be removed from the CNSX Markets recognition order prior to Alpha commencing operations as an exchange and being put in a position to list foreign issuers without the same restrictions as those that currently impact CNSX.

Question 10: Does the changing environment impact the Alpha Group application? If so, how?

It is difficult to anticipate how the continuation of the process for recognition as an exchange would impact the bid by Alpha’s owners for TMX Group, especially given the fact that Alpha has been cited as a part of their proposal but we note that any further steps in that direction should require a very clear statement on the intentions with respect to Alpha. On the other hand, the application itself has a significant impact on the environment. The most recent launch of a stock exchange in Canada represented several “firsts” at the time.³ The impact was minor, however, given the reluctance of many of the larger firms to participate. A marketplace owned by a select group of its members, be it an ATS or an exchange, would be expected to have a significant effect on the market environment if those owner/members control enough order flow. Since the launch

³ CNSX Markets Inc launched as Canadian Trading & Quotation System, Inc., July 25, 2003.

of Alpha ATS with the full support of the dealers responsible for the majority of the order flow in Canada, there has been significant change in market share and dealer participation across all markets. In consideration of both public interest and competitive concerns, and in light of Alpha's current market share and influence on the direction of member order flow, Alpha should not be granted any special consideration with respect to corporate governance or eligibility of issuers.

Comments on the Draft Recognition Order, Listing Handbook and Trading Policies

1. Qualification for Listing

As noted above, we are concerned about two major issues regarding fairness in the listing qualification. First, there is no specific condition in the draft recognition order that a listing applicant be a reporting issuer to qualify for listing. Generally, an applicant will not meet the basic float requirements in the listing criteria without being a reporting issuer. This also holds true for a CNSX applicant, but there is an appendix to the CNSX Markets recognition order that explicitly states an applicant must be a reporting issuer to be considered eligible for listing. The requirement is replicated in the CNSX Policies.

Alpha has also proposed that securities listed on certain foreign exchanges would qualify for listing on Alpha. OSC Staff have suggested to Alpha a protocol whereby they would be informed of certain applications from foreign-listed issuers, and OSC Staff would assess whether in the past a receipt would have been recommended for a similar product offered by prospectus in Canada. Alpha has agreed to notify OSC Staff, but not to consider the recommendation in the listing process.

CNSX previously proposed to OSC Staff the concept of considering issuers listed on qualified foreign exchanges to be eligible for listing on CNSX. Such issuers would still be required to meet all other listing criteria to be approved. OSC Staff expressed concerns, specifically that such issuers would become reporting issuers in Ontario without first having been subjected to a prospectus review or equivalent.

As a new exchange with unproven review procedures and a disclosure-based model similar to ours, and especially in light of Alpha's stated position that exchanges need not exercise discretion, we believe Alpha should have an explicit basic eligibility requirement in the recognition order and in the Listing Handbook – i.e., a company must be a reporting issuer or equivalent in a jurisdiction in Canada. In the alternative, given the significant changes in Canada in the past few years, if OSC Staff have now determined that such a restriction is no longer necessary, then Alpha should not be permitted to commence operations until the restriction is removed from CNSX Markets recognition order and policies.

2. Order Types

We submitted comments on both the original and revised proposals by Alpha ATS to introduce the IntraSpread facility. Despite our strong opposition to a facility that offered insignificant price improvement and facilitated trading in subpenny increments to do so, the proposal was accepted. Although not included in the list of order types described in the Alpha Exchange application, Alpha has confirmed that IntraSpread will be a feature of Alpha Exchange. We are now even more concerned about the effect on what should be considered meaningful price improvement, and trading in increments that are not permitted on visible exchanges. Furthermore, we strongly urge IIROC to reconsider the exemption granted to Alpha ATS from the requirement to report such sales.

3. Cancellations and Correction of Trades by Alpha

Section 5.8(1) of the proposed trading policies provides Alpha with “*the right to change and/or cancel any Member order or trade that has not yet been submitted by Alpha to the clearing agency clearance and settlement process for the purposes of mitigating errors made in order execution and maintaining market quality*”. There are further provisions for corrections requested by members, which are appropriate. We do not believe the exchange should have the authority to cancel or correct trades without the consent of the members. Currently, only IIROC has that authority for every other exchange in Canada and, given the inter-related nature of the equity markets, this is very important for market integrity.

Summary

Recognition as an exchange should follow a fair and transparent process, with appropriate terms and conditions included in the recognition order. To the extent possible, similar models should include similar conditions. Unless the terms of Alpha Exchange’s recognition order explicitly include the requirement, for listing applicants to be reporting issuers it should be removed from CNSX Markets’ recognition order.

An exchange must have a governance structure that ensures proportionate representation of all stakeholders, not just shareholders. This includes the investing public, so that structure must also support the exchange’s mandate to operate in the public interest. Furthermore, an exchange must have clear requirements for listed companies and members, and be prepared to exercise discretion, and do so consistently. A proposal that rejects the exercise of discretion with respect to listing matters, but asserts absolute authority with respect to cancellation of trades on the basis that they simply affect market quality is a proposal that does not appear to be in line with the regulatory objectives of an exchange.

Yours truly,

“Mark Faulkner”

Director – Listings & Regulation

cc: Ian Bandeen, CEO
Rob Cook, President
Richard Carleton, Vice-President – Corporate Development
Cindy Petlock, General Counsel & Corporate Secretary