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VIA EMAIL

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Mr. John Stevenson
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Dear Mr. Stevenson:

Re: Notice of Alpha Exchange Inc. and Alpha Trading Systems Limited Partnership – Republication for Comment of Proposed Trading Policies and Member Agreement Provisions respecting the Proposed Market Maker Program for Alpha Exchange Inc. (the "Notice and Request for Comment")

TMX Group Inc. ("**TMX Group**") welcomes the opportunity to comment on the Notice and Request for Comment as published by the Ontario Securities Commission (the "**OSC**") on September 9, 2011.

All capitalized terms have the same meanings as defined in the Notice and Request for Comment or the attachments, unless otherwise defined in this letter.

We note that no responses have been provided to the comments that relate to the Market Maker Program (MMP) in our submission of May 30, 2011 in response to Alpha Exchange's Application for Recognition as an exchange ("First Response Letter") and that certain matters we raised then remain unresolved. We refer to these matters again in this submission.

Objectives of Alpha Exchange's Market Maker Program

As submitted in our First Response Letter, Alpha Exchange proposes to appoint Market Makers for Alpha Exchange listed securities and for Other Traded Securities (OTS), which are not listed on Alpha Exchange. However, the Market Maker provisions in the proposed Trading Policies continue to describe the responsibilities for Market Makers (MMs) more as liquidity providers than as market makers.

The role and obligations of Market Makers as proposed, including the criteria for assignment of MMs and the differing compensation structure for the MMs, indicate that MMs will not be providing true and complete market making functions. Since they will not be fulfilling the obligations of true market makers, they should not receive the benefits made available to market makers under the Universal Market Integrity Rules (UMIR) in exchange for performing market making functions. Alpha's proposed MMP demonstrates how it is attempting to use Market Makers to advance its own competitive interests without balancing the interests of the market as a whole. We submit that it is inappropriate to permit liquidity providers to hide behind a shield of being called market makers and receive benefits afforded to market makers when the obligations of market makers are not being met.

Market making functions generally provide a number of benefits to the market as a whole. For example, they enhance the efficiency and effectiveness of price discovery, augment liquidity, fill liquidity ‘gaps’, support the order flow of the retail investor, provide a frontline role in monitoring trading activity, mitigate price volatility and help to stabilize the market, and support the efficiency and quality of the opening reference price in the industry. For inter-listed securities, this ensures that the Canadian market is maintained in a manner that is competitive with U.S. markets. These activities benefit all market participants. Market makers also perform a regulatory function by assisting in maintaining a fair and orderly market and supporting market integrity.

We submit that the MMs proposed by Alpha in the Notice and Request for Comment are not performing these functions. With respect to MMs for Alpha Exchange listed securities, the MM functions are already being fulfilled by the Lead Market Maker (LMM). For example, the LMM is keeping the required spread/size at the top of the book. The additional MM on the same security is not performing the same quality of function. This could potentially allow any number of participants to be classified as “Market Makers” and be exempt from various UMIR requirements such as Policy 2.1 Just and Equitable Principles; Rule 2.2 Manipulative and Deceptive Activities; Rule 3.1 Restrictions on Short Selling; Rule 3.2 Prohibition on Entry of Orders; Rule 5.3 Client Priority; and Rule 7.7 and Policy 7.7 Trading During Certain Securities Transactions. Permitting such a loose classification for market makers creates undue risk of detriment to the market and to market integrity that we submit should not be supported.

The Trading Policies provide that an LMM, and MMs for Alpha Exchange listed securities and OTS, will notify Alpha and the Market Regulator of any perceived violation of Alpha Requirements[1] (which includes Alpha’s rules and Policies, as well as UMIR and securities law). There are no other Market Maker obligations proposed that appear to be in support of market integrity or providing a regulatory function.

Contrast this minimal market surveillance obligation with the obligations of market makers on Toronto Stock Exchange (“TSX”). The TSX Trading Rules provide that market maker conduct must not be “detrimental to the integrity of the Exchange or market”[2]. TSX market makers have minimum guaranteed fill (MGF) obligations.[3] TSX market makers must report suspicious/unusual trading on their securities of responsibility to IIROC as well as assist other participating organizations in pointing out anomalies in their orders and in execution of orders when asked.[4] TSX market makers are required to ensure securities of responsibility are continuously monitored throughout the trading day.[5] TSX market makers are also explicitly reminded that certain UMIR rules apply to them, such as Client Priority, Client Frontrunning, Tipping and Trading Ahead, and Client Principal trading.[6]

Further differentiation exists between MMs proposed by Alpha for Alpha Exchange listed securities and OTS that indicates they are not true market makers. For example, Members wishing to be appointed as MM for Alpha Exchange listed securities must be willing to be assigned at least 20 securities. As there is

[1] Notice and Request for Comment (2011) 34 OSCB 9442 section 6.2(2)(e) and 6.3(2)(d).
[2] TSX Trading Rules P 4-601(1)
[3] TSX Trading Rules R 4-604 (g)(h)
[4] TSX Trading Rules P 4-604 (1)
[5] TSX Trading Rules P 4-604 (2)
[6] TSX Trading Rules P 4-604 (3)(5)(6).

always an LMM with similar obligations also assigned to each security, these MMs are merely augmenting liquidity and not providing any true market making function.

Members wishing to be appointed as MM for OTS must be willing to be assigned at least 200 securities. Realistically, other than perhaps 1-2 firms in Canada, only electronic liquidity providers will be able to accept the role of MM for over 200 OTS. It therefore appears unlikely that such MMs will perform any typical market making functions.

We note that the performance metrics applicable to the MM for OTS include odd lot dealer obligations and performance criteria and compensation structure tied to the MM's market share contribution to Alpha. These MMs are clearly incentivized to raise Alpha's market share and do not have a market making role to contribute to maintaining a healthy and orderly market. We submit that this structure may have a negative impact on the market and incent self-interested behaviour that is not in the interests of the market as a whole. The MMs for OTS are clearly liquidity providers rather than market makers and are proposed to be compensated accordingly.

Alpha is proposing to use Market Makers as a tool to drive competitive behaviour singularly focused on increasing its own market share. While there are other exchanges that have more than one market maker per security, as noted in Appendix A of the Notice and Request for Comment, other exchanges do not compensate these multiple market makers in a manner designed to increase the exchange's market share. For example, NASDAQ has a competing market maker model under which each market maker is compensated the same way. Other exchanges, such as NYSE AMEX, clearly recognize that other than the designated market maker (DMM), the other market makers are liquidity providers i.e., supplemental liquidity providers (SLP), without the same market maker obligations or privileges.

We therefore submit that MMs for Alpha Exchange listed securities and MMs for OTS are not market makers, but are liquidity providers, serving to further Alpha's competitive interests, and should be named appropriately and not benefit from the exemptions that are applicable to true market makers.

LMMs

It is proposed that issuers may negotiate with their LMM to set better spread/size commitments than the Standard Requirements.[7] Typically TSX market makers are permitted to short sell to keep the agreed upon spread – will an LMM be permitted to short sell to keep an *issuer* requested spread? We submit that permitting the issuer to dictate market conditions will create conflicts and could have far reaching market implications. We therefore submit that this should not be permitted.

It is also proposed that LMMs receive additional compensation if they achieve the specified percentage of volume at the opening auction, thereby incenting them to capture a specified percentage of volume on the opening rather than absorb imbalances and provide for an orderly opening. Incenting MMs to capture volume targets could lead to more price volatility on the opening and is not in line with best execution obligations or market maker obligations more generally. This mitigates the likelihood of an MM managing an orderly opening and may negatively impact market quality. We therefore submit that this aspect of the compensation structure is focused on inter-market competitive issues rather than market quality, and therefore is inappropriate and should not be permitted.

[7] (2011) OSCB 34 OSCB 9429 section 1) a.

Trading in the Odd Lot Book

Also as submitted in the First Response Letter, we question why orders booked in the Alpha odd lot order book will not be disseminated on the public data feed. In our view, this is data that is valuable to the market from a price discovery perspective and it should be disclosed. If Alpha is permitted to continue to operate an undisclosed order book for odd lots, these orders would then appear to be dark orders and should be required to follow existing rules for dark orders. Specifically, these odd lot orders should only execute when they can be price-improved rather than simply execute at the NBBO. Similarly, it is not clear how the Alpha odd lot order book enables participants to meet their UMIR 6.3 obligation to immediately expose client orders, as client odd lot orders would neither be immediately disclosed nor price-improved. The lack of opportunity to price improve within the NBBO would also breach best execution principles. It is our view that Alpha should not be permitted to operate its odd lot order book as a non-displayed book until it complies with these requirements.

Other Submissions

It appears that a Market Maker (Alpha Exchange listed and OTS) can be the market maker for a security on more than one exchange. We question how it is possible that a true market maker could fulfil certain of its main roles and obligations in the best interests of more than one marketplace without any negative impact on the market. For example, spreading liquidity across two markets lessens liquidity on both and can weaken price discovery on both. The conflict of interest seems clear if this is the case.

As submitted in our First Response Letter, the definition of an “Approved Trader” permits “an employee of a client of a Sponsoring Member” to be an Approved Trader. We submit that this definition is too broad and does not support accountability, supervision, monitoring and investigative processes and practices related to direct market access (DMA) trading. Such employees are not subject to regulation and may be outside of the jurisdiction of Canadian regulators. Further, we believe that it is a market integrity concern that Approved Traders are given the ability to fulfil a Market Maker’s responsibilities. Approved Traders for Market Makers should not be permitted to be an employee of a client of a Sponsoring Member.

We would be pleased to discuss our submission further at your convenience.

Sincerely,

Kevan Cowan

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TMX Group Head, Equities