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VIA EMAIL

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Attention: OSC Staff and Ms Pavalow

Re: Alpha ATS LP Request for Feedback on Alpha IntraSpread Facility

TMX Group is appreciative of the opportunity to comment on these proposed order types. It is salutary that the OSC has finally provided marketplace participants with the same opportunity to comment on ATS order types as they do with exchanges. Such an opportunity, while unfortunately late in the development of the multi-marketplace environment, brings necessary transparency to at least future ATS rulemaking.

We understand that OSC staff will approve dark order types on new and existing marketplaces if, among other things, the proposed orders maintain the status quo. For reasons set out in this letter, we believe that the order types proposed by Alpha in its IntraSpread facility move far past the status quo for dark orders.

The only Canadian marketplace that currently has approval for and enables "internalize only" features that may be considered comparable to Alpha's proposed facility is Triact's MatchNow ATS. However, we believe Alpha's proposed model is significantly different than MatchNow's or any dark order types currently in existence on other marketplaces, and therefore their approval would be inconsistent with OSC staff's intention to maintain the status quo.

Specifically these differences include:

- CHI-X's, Alpha's and TSX's approved dark order types should not be considered as precedent for approval given the unique internalization only nature of Alpha's proposed order types.

- Matchnow's approval for similar features was granted under the auspices of a 'call market' exemption. In contrast IntraSpread is continuous in nature. As such, the IntraSpread facility should be considered as a new model given it would be the first continuous marketplace to offer such internalize only features.

- IntraSpread provides additional features that give the IntraSpread user unprecedented control to systematically provide micro-penny price improvement to marketable customer orders without exposing those customer orders to other dealers.

- IntraSpread allows the equivalent of MatchNow's "marketflow" order to come in as internalize only, whereas Matchnow ensures that "marketflow" orders are exposed to all dealers.

- IntraSpread allows the resting order to price improve by a minimum of 10% over the NBBO, whereas MatchNow's internalize only orders impose a minimum 20% price improvement.

In this letter, TMX Group advocates for the CSA and IIROC to formalize policy relating to internalization methods and dark trading. In the interim, it is clear to us that the order types proposed by Alpha do not represent the status quo in Canada and should not be approved by OSC staff on that basis.

Dealer Internalization

The Alpha proposal is sometimes referred to as a dark liquidity pool. It is, in fact, primarily a dealer internalization model. This model will allow a dealer to selectively match its client order flow with its proprietary flow or other client order flow on Alpha, and potentially with selective dealers, rather than exposing these client orders on a marketplace to interact in a central limit order book with all participants. This internalization mechanism can occur with minimal price improvement for retail client orders – as low as 0.1 cent per share. In the Canadian market where retail order flow is concentrated among few dealers, this type of proposed internalization model could lead to weakened price transparency, decreased liquidity, and deteriorated price discovery on the visible marketplaces to the detriment of all investors.

As TMX Group has stated previously, internalization benefits a specific segment of intermediaries but it does not benefit the investing community as a whole. We continue to believe that it is vital for all investors to be provided with true fair access to Canadian liquidity venues. Our submission will highlight that the Alpha proposal is fraught with issues that raise market integrity concerns – both in terms of fair treatment of investors, and concerns related to ensuring the vibrancy of Canadian capital markets through the existence of strong visible marketplaces.

Policy Making Through Rule Review

The Alpha proposal raises some very important topics that should be addressed directly by the CSA and IIROC. These regulatory principles should be deliberated in a public manner. Policy determinations resulting from such debate should be clear and concise. It is our view that the CSA should not approve the Alpha proposal, or any other marketplace internalization vehicle or dark strategy, in the absence of a clearly articulated, public stance on these matters.

The first principle to be settled is the extent to which the CSA and IIROC are willing to allow dealer internalization to expand. TMX Group's submission in response to CSA Consultation Paper 23-404 warned that any policy or regulation around dark trading must consider and encompass internalization activity. The continued expansion of dealer internalization networks, whether at a dealer, through an inter-dealer liquidity venue, or on a marketplace such as Alpha, is a serious threat to transparent price discovery on visible marketplaces. To adequately address this threat, the CSA should stipulate clear principles that will preserve the liquidity on visible marketplaces. In the absence of official policy and clear guidance, regulatory values can shift (often inadvertently) as policy becomes created through piecemeal marketplace rule and order type approvals. The continued absence of sufficient regulatory policy around dealer and marketplace treatment of non-displayed liquidity would further reinforce the inconsistency in regulation between marketplaces and dealers, and implicitly encourages the introduction of systems or features that capitalize on these inconsistencies. Such regulatory arbitrage opportunities must be eliminated.

Another principle to be dealt with by the CSA and IIROC is what constitutes meaningful price improvement. Originally, UMIR rules related to price improvement were created for two purposes: to ensure the fulfillment of dealers' fiduciary obligations to their clients and to preserve liquidity on the Canadian equity exchanges. As the Canadian multi-marketplace environment has evolved, the concept of meaningful price improvement has been compromised such that certain marketplaces offer only fractional or no price improvement on incoming orders. TMX Group believes that meaningful price improvement should be required and that the CSA and IIROC must determine an acceptable level of price improvement in order to ensure integrity and fairness in our markets. If the Alpha proposal is approved, the result will be that not only is fractional price improvement acceptable, but a market structure that seeks to minimize price improvement is deemed acceptable. We submit that the goal of minimizing price improvement will discourage the posting of visible orders, and lead to dangerous repercussions in our market. We urge the CSA to establish a principled rule on price improvement that will uphold market integrity and have the effect of fair application across all venues.

Regulatory Comments on Alpha Proposal and Questions for OSC Staff

Broker Exclusion and Fair Access

The order types proposed by Alpha take Canadian public equity markets into new and dangerous territory. We understand that the proposed Seek Dark Liquidity order (SDL Order) and related dark order type (Alpha Dark Order) can only result in a trade when the same dealer supplies both orders to the execution. Thus, an SDL Order from Broker A can never execute with an Alpha Dark Order from Broker B. This system of broker exclusion will essentially result in pockets of liquidity residing on the Alpha marketplace that are only accessible to certain participants. Contrary to the concept of a public marketplace, under the Alpha proposal its approved participants will not receive the benefit of equal access to the orders contributed by other Alpha participants. This undermines the Canadian markets principle of fair access.

Additionally, we question how these order types are consistent with the fair access provisions of National Instrument 21-101 (specifically section 6.13(b)) which requires that an ATS shall not unreasonably prohibit, condition or limit access by a person or company to services offered by it. The guidance on this rule in Companion Policy 21-101 CP explains that "the purpose of these access requirements is to ensure that the policies, procedures, fees and practices of the ATS do not unreasonably create barriers to access to the services provided by the ATS".[1] Given that trading and execution are services[2] offered by Alpha, it is an unreasonable barrier to offer order types that will never have the opportunity to execute against the orders of any other participant.

Preferencing order flow as a part of marketplace allocation methodology is entirely different from a marketplace that enables dealers to selectively prevent inter-dealer order matching. We are troubled that Canadian securities regulators would permit a marketplace to promote a two-tiered market structure whereby a large number of participants will be excluded from interacting with order flow that should be exposed to the market. While dealers are permitted to internalize client order flow within prescribed parameters set out in UMIR, marketplaces that are accountable to a variety of stakeholders should be held to a higher standard and should not be used as an outsourced internalization vehicle. This activity is particularly egregious when the price improvement requirements imposed on internalizing dealers can effectively be circumvented by instead internalizing the orders on Alpha through these new order types with meaningless price improvement (discussed below under the heading "Meaningful Price Improvement"). Moreover, we believe that these dangers are potentially heightened in the Canadian marketplace given the high concentration of order flow among relatively few dealers.

The Alpha proposal also creates a harmful precedent, whether implicitly through the use of jitney orders (discussed below under the heading "Jitney Orders"), or explicitly through the anticipated expansion of this facility, if the dealer exclusivity is extended to selective groups of dealers thereby permitting a dealer consortium to execute orders among themselves without first exposing the orders to other Alpha participants. We would consider the facilitation of selective preferencing among inter-dealer groups to be a flagrant violation of the fair access principles in National Instrument 21-101, and our concerns related to the possible effects of diminished price discovery and lower liquidity levels on visible marketplaces will be heightened if the Alpha facility is permitted to operate in this manner. Further, the result would effectively be the operation of an unregulated ATS within a regulated ATS, as a dealer consortium would be permitted to match order flow with other specified dealers in a selective manner, under the auspices of a facility of the Alpha marketplace.

In addition, the dealer exclusion and selection characteristics of the proposed facility may significantly impair fair competition among dealers, where those dealers who either do not support or command the type or scale of flow that this facility caters to will be disadvantaged. The impact to a smaller dealer's ability to fairly compete resulting from the proposed Alpha IntraSpread facility will encourage, and perhaps compel, smaller dealers to enter into arrangements with larger dealers so that their flow can interact with these exclusive liquidity silos. Such arrangements where dealers sell the ability to interact with their retail flow to another dealer or customer allows the dealer to benefit as the proprietor of its customer's order flow but absolves the dealer from any proprietary obligation to give meaningful price improvement to that customer flow. A statement in Alpha's newsletter dated August 6, 2010 titled "*Alpha IntraSpread*

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[1] Companion Policy 21-101 CP to National Instrument 21-101 Marketplace Operation, section 8.2(1).

[2] Companion Policy 21-101 CP to National Instrument 21-101 Marketplace Operation confirms at section 8.2(3) that the reference to "services" in paragraph 6.13(b) of the Instrument means all services that may be offered to a person or company and includes all services related to order entry, trading, execution, routing and data.

Facility: Facts Versus Mischaracterization" encourages dealers with retail flow but no proprietary trading to sell the ability to interact with their retail flow rather than send their customer orders to the central limit order book of a lit marketplace. These issues raise concerns around the fairness and equal access implications of such arrangements, put at risk the continued competitiveness of such dealers, encourage client flow to migrate away from such dealers, and support an increased concentration of order flow among few dealers in the Canadian market.

Jitney Orders

Our understanding of the Alpha proposal is that a jitneyed Alpha Dark Order will match with an SDL Order of the executing dealer. The match will not "look through" to the originating broker, but rather the executing dealer is the trigger on the match between an SDL Order and an Alpha Dark Order. If this is the case, the result is a dangerous market structure phenomenon whereby a dealer can form a consortium of preferred counterparties for purposes of the Alpha facility, to the exclusion of other dealers. This dealer selection model would have the effect of producing an additional exclusionary tier within the Alpha marketplace and would result in the creation of deeper isolated liquidity pockets within Alpha that are not accessible to all participants. This practice calls into question the same access concerns that we raise above and begs the question of whether the use of jitney orders will be abused by participants in order to join in these exclusive liquidity pools. It is our view that if the proposed order types were to be approved in any form, jitneyed orders should not be treated as orders of the executing broker for purposes of this facility.

Meaningful Price Improvement

The mechanics of the proposed Alpha Dark Order and SDL Order will permit dealers to execute on Alpha against their own client orders with less price improvement for the client than if the dealer had simply internalized the trade, because the UMIR rules that govern dealer internalization have the effect of requiring full tick price improvement, whereas the Alpha Dark Order and SDL Order can execute at as little as one-tenth of one cent improvement. These Alpha order types therefore will enable dealers to do indirectly what they cannot do directly.

The concept that meaningful price improvement for a client has historically been measured by at least one trading increment is supported in UMIR Rule 6.3 – Exposure of Client Orders. Under UMIR Rule 6.3(1)(b) a dealer must immediately enter a client order[3] on a lit marketplace unless the dealer executes the client order upon receipt at a better price. Because orders on a marketplace must be entered in whole cents (with a half-penny exception for an order with a price of less than $0.50[4]), the cross containing the price-improved client order would traditionally be printed on a marketplace at a price that could only accept the cross in whole cents; hence a full cent improvement for the client.

UMIR Rule 8.1(1) – Client-Principal Trading permits a dealer that receives a client order to execute the client order against a principal order or non-client order at a better price provided the dealer has taken reasonable steps to ensure that the price is the best available price for the

[3] For purposes of this submission, "client order" means a client order for 50 standard trading units or less of a security with a value of $100,000 or less.
[4] UMIR Rule 6.1(1) Order Entry and Exposure – Entry of Orders to a Marketplace.

client under prevailing market conditions. The related policy is clear that “best available price” does not simply mean any price improvement over the best posted price, however small. In fact, UMIR Policy 8.1, Part 3 lists a number of factors in determining “best available price” and provides a scenario where the client’s offer to sell shares should be executed by the dealer at the national best offer, and not merely at a few trading increments above the national best bid.

The Alpha proposal would allow proprietary trades to execute with client orders at a price that gives as little as one-tenth of one cent improvement to the client. This amounts to a marketplace establishing a mechanism for dealers to do indirectly what they can’t do directly. This should not be permitted in the Canadian marketplace. The CSA and IIROC should eliminate any inconsistencies in the application of rules that govern marketplaces, dealers, and dealer operated non-displayed facilities. Not enforcing full tick price improvement over the NBBO supports and promotes these inconsistencies, and creates a regulatory subsidized competitive advantage to dark facilities over lit marketplaces by directly encouraging the quoting on undisplayed over displayed venues. If sub-penny price improvement continues to be permitted, accordingly the inconsistency must be addressed by allowing visible marketplaces to quote in sub-pennies – a result that would have considerable impact on the Canadian market.

To reiterate our position as outlined in TMX Group’s submission in response to CSA Consultation Paper 23-404, we believe that any dark trading, including internalizing features and practices, whether through a marketplace such as Alpha’s proposed facility, or through a dealer’s own systems, must provide meaningful price improvement over the displayed national best bid or offer (NBBO). It is critical that regulation encourages and supports the continued integrity and value of the visible market and price formation process by providing an incentive for the public display of liquidity. This requires internalized and non-displayed trading to provide meaningful price improvement over the displayed NBBO. Sub-penny price improvement is not adequate improvement to justify the yielding of priority of a previously posted visible quote. A minimum full cent price improvement is meaningful and should be required and enforced by regulators.

We recognize that sub-penny price improvement is currently being provided on marketplaces such as MatchNow, CHI-X, and Alpha. As we have previously noted, these features were introduced without any public or transparent industry consultation, and in the absence of formal regulatory policy on dark trading and internalization. For example, the original approval of MatchNow’s price-improvement model was granted on the basis of its status as a call market, and not pursuant to clear regulatory policy regarding trading of non-displayed liquidity.

TMX Group does not believe that the sub-penny price improvement and internalize-only features currently in operation, or seeking approval, should be permitted to continue or be granted approval until the industry concerns raised around these issues are resolved. The industry needs clear policy from the CSA and IIROC to guide existing and future marketplace and dealer operations. It would be premature to approve the Alpha IntraSpread facility in the absence of thoughtful definitive policy from the regulators on this issue. Presumably one goal of this year’s public forum on dark pools was to allow the regulators to evaluate industry views on these important topics, and move toward finalizing formal rules and policies. TMX Group has significant concerns with the ‘policy by default’ approach that arises through one-off rule and order-type approvals without the benefit of public principles to support these market structure changes that can significantly impact the entire market.

Best Execution

National Instrument 23-101 requires dealers to make reasonable efforts to achieve best execution when acting for a client[5]. Companion Policy 23-101 CP describes a “reasonable efforts” test which requires a dealer to demonstrate, among other things, that it has abided by its policies and procedures that outline a process designed to achieve best execution. Given the concerns raised above regarding dealer internalization opportunities on the new Alpha facility and the potential for diminished price improvement on client orders, Alpha participants that use these new dark orders should be required to clearly demonstrate execution quality in this facility before diverting client orders away from other lit marketplaces. It would be extremely concerning if clients were missing fill opportunities or losing time priority in the visible book due to the additional latency associated with systematically routing orders first to a facility with questionable execution value. We note that the price improvement and fair access concerns we raise above become even more acute if dealers were permitted to default client orders to SDL Orders before they route to displayed markets as regular market orders.

We submit that the “reasonable efforts” test should be onerous on the dealers in these circumstances and that the metrics they reference as justification for diverting customer order flow away from other lit marketplaces with multiple dealer participation should be clear and compelling. We note that many Toronto Stock Exchange-listed symbols maintain a single tick bid/ask spread throughout the day and adequate liquidity exists (with additional market maker guarantees on Toronto Stock Exchange) to trade an average sized client order at the best price. Under these conditions, we do not believe that trading client orders in an internalized manner with de minimus price improvement on Alpha could be justified when compared to the trading opportunity on other lit Canadian marketplaces. If these new orders were to be approved in any form, we believe that the dealers utilizing the orders must be subject to stringent best execution reviews by IIROC and the CSA to ensure best execution compliance.

We urge the CSA to review policies and principles in the Markets in Financial Instruments Directive (MiFID) that address best execution concerns and deal with internalization practices. For best execution, MiFID requires investment firms to demonstrate that best execution is served when routing to a specific venue, and investment firms are required to disclose their order handling policies to their customers.[6] With respect to internalization, MiFID prohibits

[5] National Instrument 23-101, section 4.2.
[6] MiFID Article 21: http://www.markets-in-financial-instruments-directive.com/Article21.htm

Section 3. The order execution policy shall include, in respect of each class of instruments, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client order.

Member States shall require that investment firms provide appropriate information to their clients on their order execution policy. Member States shall require that investment firms obtain the prior consent of their clients to the execution policy.

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the investment firm shall, in particular, inform its clients about this possibility.

systematic internalizers from offering hidden liquidity in highly liquid symbols and instead requires firm public quotes from these systematic internalizers, with no ability for these entities to selectively deny access to their quotes.[7]

Order Pricing and Wash Trades

Will the Canadian securities regulators and IIROC permit a trader or traders within a given dealer to place buy and sell orders in a single security in the Alpha facility at overlapping prices? For example: Broker A simultaneously places a passive internalize buy (Alpha Dark Order) at 90% spread and a passive internalize sell (Alpha Dark Order) at 90% spread for symbol ABC. Would this be considered manipulative and deceptive activity contrary to UMIR Rule 2.2[8]? If this practice would be contrary to UMIR, will Alpha be required to establish automated marketplace-level protections that will prevent this scenario from occurring?

Public Markers

If approved in any form, does OSC staff intend to impose a distinct public marker requirement on executions in this facility to show that the trade resulted from an internalization process, to distinguish from trades effected through multiple dealer interaction on a marketplace?

Regulatory Comments - Summary

We urge OSC staff to review the Alpha order types within the context of the regulatory goals of fair access, best execution, and fulfillment of fiduciary duties to clients. These goals have formed the pillars of much of the market integrity legislation that has been drafted over the past decade. The principles that are applied to dealers through UMIR should be preserved, and in fact enhanced, by marketplace executions – not circumvented by new marketplace order types. We believe that a comprehensive review of Alpha's proposal will show that these new order types will lead to consequences that have a negative impact on the integrity of our markets, and should therefore not be allowed.

<u>Questions for Alpha Related to IntraSpread Functionality</u>

We also have a number of questions regarding the functionality of the Alpha Dark Order and the SDL Order, which we raise below. We believe that further public details should be provided with respect to these order types so that dealers and other marketplaces can understand how they work and how they may impact the market as a whole.

Member States shall require that investment firms obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF. Investment firms may obtain this consent either in the form of a general agreement or in respect of individual transactions.

[7] MiFID Article 27: http://www.markets-in-financial-instruments-directive.com/Article27.htm

Section 1. Member States shall require systematic internalisers in shares to publish a firm quote in those shares admitted to trading on a regulated market for which they are systematic internalisers and for which there is a liquid market.

[8] See UMIR Policy 2.2, Part 2(b).

Last Sale Price

Given that this facility is continuous and the Alpha proposed orders are not special terms orders, it is our expectation that if approved in any form these trades will update the national last sale price. We understand this to be the case currently for mid-point orders that are executed on CHI-X in half-pennies. However, the Alpha notice (without supporting rationale) states that these orders would not update the national last sale price. Please explain why execution prices in this facility would be excluded from the national last sale price.

Execution Price

The example in the notice shows a one cent price improvement. Is it correct that in this example even if the resting order was prepared to give 90% improvement, the facility would cap the execution price to prevent the resting order from giving more than one cent improvement? In other words, the facility gives 50% NBBO spread improvement to the active order even though the resting order instructed Alpha to give 90% improvement. Please confirm our understanding.

Execution Queue

Please explain how orders at the same executable price would be allocated relative to each other. If the example in the notice was modified so that a 90% spread order was resting, would the 90% spread order get priority over a previously entered order with a 50% spread improvement? Specifically, would price improvement trump time priority in the facility, all else being equal? Or would priority be based on size or some other automated method?

Trade Data

Would this facility's executions at 3 and 4 decimal points be rounded to full trading increments on public trade reports and on data supplied to the information processor? If rounding will occur, please describe whether rounding would always be higher to either a full trading increment or to the nearest full cent, or whether the price could be rounded up or down at Alpha's discretion to the nearest trading increment or to the nearest full cent.

What information is reported back to the SDL Order provider when a trade occurs? How much information would be provided regarding resting contra-side interest from the same dealer? For example, would the report reveal the number of contra orders that participated in the match, the remaining resting volume of those orders, the unique trader identifier, trader name, etc.? We note that the fill response is not included in the example provided in the notice. Similarly what information would be reported back to the Alpha Dark Order provider when a trade occurs? Specifically, what information would be provided with respect to the contra-side's order(s)? Would the Alpha Dark Order provider know the size of the SDL Order, trader id, etc.? If an SDL Order provider participated in Alpha's two stage routing feature and ultimately got filled, would the SDL Order provider know explicitly whether or not he was filled in this facility or in the second stage of the route in Alpha's regular book?

Functionality Questions - Summary

Answers to these questions will allow participants and marketplaces to grasp how the facility would function, and may raise additional concerns or issues that should be considered by the

OSC as part of any approval process. Given the policy concerns that we have raised in this letter, it is necessary for all participants to understand how these new orders will operate in order to determine the impact that they could have on our market structure. We urge OSC staff to continue this transparent feedback process by making public Alpha's responses to all comments received so that market participants are provided with full and equal information.

Conclusion

It is our view that OSC staff should not approve the proposed Alpha orders as these order types move far beyond the status quo for dark trading and internalization mechanisms. Furthermore, OSC staff should not finalize their review of the Alpha proposed order types until the CSA and IIROC formalize market structure policy relating to internalization methods and dark trading. The unique composition of the Canadian trading market produces an unusually high concentration of order flow in relatively few dealers. We believe that internalization features such as those proposed by Alpha will have a disproportionate negative impact on liquidity and price discovery across Canadian marketplaces.

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

Yours truly,

Kevan Cowan

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