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Attention: OSC Staff and Ms Pavalow

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

Chi-X Canada ATS Limited (Chi-X Canada) appreciates the opportunity to comment on Alpha ATS LP's proposal to introduce IntraSpread - a dark facility. Although we have operated a lit marketplace since March 20, 2008, we believe that there are many benefits that are offered by dark forms of liquidity including dark order types and dark pools. However, the market characteristics of IntraSpread extend the issues created by broker preferencing, and raise concerns surrounding transparency, price discovery, and fair and equal access.

Broker Preferencing

The market mechanic of broker preferencing has been an accepted feature of the Canadian landscape for several years, originally intended to enhance transparency by encouraging the printing of "upstairs trades" on an exchange. Changes in market structure, competition, and technology over the past decade have transformed prior practices such as broker preferencing into a mechanism that now creates an unfair advantage for certain participants. It allows certain participants to step ahead of "risk takers" (e.g., price setters) by "jumping ahead" of previously established and publicly displayed prices.

This practise has contributed to the disproportionately high concentration of order flow across a limited number of participants and has prevented the Canadian market from fully harnessing advancements in technology, competition, and operational efficiencies. In Chi-X Canada's response letter to CSA/IIROC Consultation Paper 23-404 *Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada*, we outlined several of the negative impacts of broker preferencing. Many of the same problematic elements contained in broker preferencing are contained in IntraSpread.

- A disincentive for those who are not customers of the preferred dealers to provide liquidity thus adversely impacting quote competition and price discovery.
- The appearance of a two-tiered market, undermining investor confidence.



- The potential to undermine market integrity by allowing market structure opportunism to trump the ability to deliver value.
- The creation of an inappropriate incentive for liquidity providers to become customers of the large preferred dealers.
- An incentive for large brokers to forgo investing in technology or product in favor of building market share by capitalizing on their size and captive order flow (e.g., retail or institutional). This also allows brokers to "sell" the ability to obtain "a first look" at incoming orders without having to take on the risk of "price setting".¹

Alpha's IntraSpread Facility

The IntraSpread facility extends the questionable practices of broker preferencing to the next level. The same participants who benefited most from internalization opportunities offered by broker preferencing would now have the ability to more deliberately optimize internalization opportunities. Dealers who choose not to, or can not compete at the NBBO, even through broker preferencing, can now trade ahead of publicly displayed quotes for a fraction of the minimum tick size. By offering insignificant price improvement, IntraSpread order types allow dealers to circumvent the current price improvement requirements set out in UMIR.

If successful, IntraSpread may adversely impact the liquidity in the public market by siphoning large segments of order flow into the hands of a limited few. Not only will this represent a step back from the trend of democratizing access to order flow, it will lead to greater fragmentation, giving life to pools that are inaccessible to the majority of market participants. Concerns about fragmented liquidity are exacerbated by Alpha's Jitney allocation methodology. By allowing participants to resell their broker ID's to other brokers on a selected basis, small or intermediate dealers may be incited to aggregate their orderflow with larger brokers through jitney arrangements to gain access to these exclusive pools of liquidity.

Some may argue that the facility does not violate Canada's fair and equal access provisions because it is available to all subscribers. However, since there are no fair access requirements relating to Jitney, participants have the ability to restrict access to their orderflow through Jitney arrangements. As a result, the IntraSpread facility could lead to undermining the purpose of Canada's fair and equal access provisions. Exclusive pockets of liquidity can be created that may restrict access to certain participants. What would not be permitted by a new marketplace is otherwise permissible through an order type. In addition to risking the creation of an unlevel playing field, IntraSpread will lead to a cycle of further market segmentation, a less robust price discovery mechanism, and the continued deterioration of the public markets.

The key benefit of IntraSpread most commonly cited is that it guarantees price improvement for active orders. If successful, it has the potential of reducing transparency by siphoning off liquidity from the public markets, thereby widening spreads resulting in

¹ See Chi-X Canada's response letter http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20100105_23-404_cohent.pdf



higher implicit trading costs for customer orders in the long run. Which price is better for a customer – trading at the NBBO with a one penny spread or receiving a 10% price improvement on a two penny spread that was once a penny?

Finally we note that it is an interesting development that, whereas most marketplaces are able to capture higher margins by offering dark order types, Alpha has chosen to implement a fee schedule that is lower than trades on its lit book. Offering a facility that encourages order flow to be directed away from their lit venue at discount is an interesting value proposition. If the commercial benefit to the franchise is not the objective, then who are the ultimate beneficiaries?

In addition to the concerns outlined above we have the following questions not addressed in Alpha ATS LP – Notice of Proposed Changes and Request for Feedback:

Opt-in: Do customers opt-in or out when sending orders to this facility?

Trade Data: How will trades that occur within IntraSpread be marked? What information will be provided to participants about their trades when an execution occurs? Will consumers of Alpha market data products that include this information have to pay for data derived from order flow they are unable to interact with?

Last sale: Will executions on IntraSpread update the national last sale price? It would appear that as proposed, IntraSpread is a continuous market and, because SDL and LP order types are not considered special terms, trade executions on this facility should update the NLSP.

Best Execution: What will dealers be required to provide to the regulators in order to demonstrate best execution has been achieved for client orders transacted in this facility? As there is no certainty of execution for SDL orders entered in the facility, there is a possibility of missing an available trade on the public market. How will instances where orders have forgone available execution for potential price improvement be captured?

Order Exposure: How will orders entered on IntraSpread be in compliance with the order exposure rules?

We thank you for the opportunity to comment at this proposal and would be pleased to discuss our comments further with you upon request.

Yours Truly,

“Tal Cohen”

CEO, Chi-X Canada