BMO Financial Group

December 8, 2014

Market Regulation Branch
Ontario Securities Commission
22nd Floor, Box 55
20 Queen Street West
Toronto, ON M5H 3S8
marketregulation@osc.gov.ca

Colin Yao
Legal Counsel, Regulatory Affairs (Equity Trading)
TMX Group
The Exchange Tower
130 King Street West
Toronto, ON M5X 1J2
tsxrequestforcomments@tsx.com

Re: Alpha Exchange Inc. ("Alpha") Notice of Proposed Rule Amendments and Request for Comments

BMO Nesbitt Burns Inc. ("BMO") welcomes the opportunity to provide comments on the proposal put forward by the TMX Group to amend the TSX Alpha Exchange Trading Policies (the "Proposals").

We appreciate the efforts of the TMX Group to compete on verticals aside from pricing. The Proposal to decommission Alpha IntraSpread will help reduce fragmentation in Canadian markets, in turn improving the overall quality of the market. In addition, we support the elimination of an opening auction for TSX/TSX Venture listed securities on Alpha as well as several of the other Proposals as they streamline operations on Alpha.

While we commend TMX for proposing a commercial solution to address competition from US wholesalers for cost effective execution in Canada (via the introduction of the 'speed bump'), we would like to highlight proposal few negative effects a speed bump may cause. In general, we are concerned with the recent changes proposed by Aequitas and Alpha relating to speed bumps and feel that they set a worrying precedent that will cause other marketplaces to follow suit. We caution that speed bumps have wider implications than beyond the marketplace it is introduced on as they encourage market segmentation and can negatively impact the quality of execution in the Canadian marketplace as a whole.

Alpha speed bump

The main topic at hand that we would like to discuss is the proposed "speed bump" on Alpha. On the surface, the proposal looks to improve the economics of active trading in Canada by encouraging market makers on Alpha to post in greater size. Market makers would have to pay a rebate to the active trader since Alpha is an inverted market. In return for this payment, Alpha is

effectively providing a mechanism for the market maker to 'fade' their quote against larger orders by observing the activity on other marketplaces before getting hit on Alpha (or conversely cancelling orders elsewhere after getting hit on Alpha). The random nature of the delay makes it impossible for commercial solutions that normalize delays to mitigate the fading liquidity as such solutions rely on adding a fixed delay to the sprayed orders.

In our view, by implementing a speed bump there will be greater liquidity at a cheaper rate, but less certainty of execution. Smaller orders will enjoy the benefit of greater liquidity at the expense of larger orders that cannot access the full quote in its entirety. Therefore the market will be implicitly segmented between small and large orders.

Other alternatives to speed bumps that help address liquidity/execution fees

There are a couple of alternatives that could address the issue of active execution fees for retail orders. As with any proposal, we recognize that there will always be trade-offs and the decision faced is to determine which trade-off is acceptable.

- **Alpha IntraSpread model** – Alpha IntraSpread provided a clean retail stream to market makers who in turn provided price improvement for both the end client as well as cheaper execution fees. Alpha IntraSpread is no longer compatible under the current dark pool rules but we feel this is probably the best trade-off scenario in helping Canadian markets compete with US wholesalers for retail flow. While we would prefer as little segmentation in the markets as possible, if such segmentation is inevitable then we believe it should be segmented explicitly (rather than the proposed implicit segmentation due to speed bump), leaving the sanctity of the executable quote intact.

- **Reduce trading fee caps** – Bringing down the highest take fees (or highest rebate paid out) explicitly would make Canadian markets more competitive from a cost perspective, although with the downside being reduction in HFT market making (wider spreads at the margin to offset the rebate). We recognize that this is a fine balancing act and would recommend ratcheting down the maker/taker fees rather than an all-out ban.

Suggestions on the proposal if approved

We see an inherent conflict in granting marketplaces the ability to exert control over routing outcomes without the participant having any recourse. Speed bumps, due to the Order Protection Rule ("OPR"), potentially delay orders to all protected markets instead of just the marketplace implementing it. As such, we recommend not granting protected market status (regardless of market share) to any marketplace that implements constraints to order routing that can impact outcomes beyond their operations.

In addition, if the Alpha's proposed speed bump is approved, we would recommend that any future speed bumps only be allowed on 'inverted' markets simply on the principle of fairness. If an active participant is paying to access liquidity, then there should be a reasonable expectation of capturing that liquidity without being subjected to a speed bump.

Alpha vs Aequitas speed bump comparison

We are concerned about the precedent the Proposals set for other marketplaces. Although a precedent has already been set with Aequitas' speed bump, we see a few fundamental differences with the objective of the Alpha speed bump. We highlight and contrast some of the nuances between the Aequitas and Alpha speed bump proposals:

Table 1 – Comparison of Aequitas vs Alpha speed bumps:

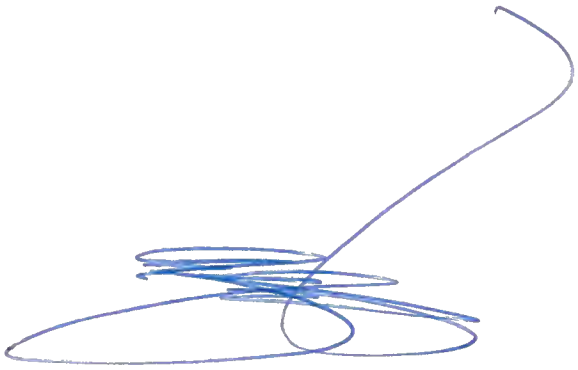
	Aequitas	Alpha
Speed bump applies to	Only active HFT orders	All active orders
Type of passive HFT it caters to	Arbitrage (ETF, interlisted)	Arbitrage (ETF, interlisted) and market makers
Benefit to passive HFT	Ability to fade against faster HFTs	Ability to fade against larger orders and faster HFTs
Benefit to retail investor	More 'liquidity' available on ETF/interlisted names	More 'liquidity' available on the quote at a cheaper cost of execution for small orders
Benefit institutional investor	More 'liquidity' available on ETF/interlisted names	More 'liquidity' available on the quote at a cheaper cost of execution for worker (smaller) orders
Issues	Explicit market segmentation between natural and HFT orders (that can experience fading quotes)	Implicit market segmentation between smaller and larger orders (that can experience fading quotes)
Market Makers	In return for guaranteed participation, rigorous market maker obligations, including minimum requirement for presence on NBBO (reduces impact of fading)	TSX Market Maker model (less rigorous)

In closing, we caution that the proposal, while interesting and even beneficial to an extent in isolation, can cause unintended negative consequences to the market as a whole and set further precedent for other marketplaces to follow suit. The end result could undermine the sanctity of quoted liquidity and in the process deteriorate the quality of execution in Canadian markets.

Nonetheless, we are appreciative of the TMX Group suggesting changes to help the competitiveness and quality of the Canadian market and encourage them to continue innovating and thinking of ideas that compete on verticals outside of price.

Should you have any questions regarding our comments on the Proposals, please feel free to contact us at the coordinates below.

Sincerely,



Rizwan Awan, CFA
Managing Director, Equity Products
BMO Capital Markets
1 First Canadian Place, 3rd Floor Podium
T: 416-359-5195
rizwan.awan@bmo.com

James Ehrensperger, CFA
Managing Director, Equity Products
BMO Capital Markets
1 First Canadian Place, 3rd Floor Podium
T: 416-359-4351
james.ehrensperger@bmo.com