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and

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

The Canadian Security Traders Association, Inc. is a professional trade organization that works to improve the ethics, business standards and working environment for members who are engaged in the buying, selling and trading of securities (mainly equities). The CSTA represents over 850 members nationwide, and is led by Governors from each of three distinct regions (Toronto, Montreal and Vancouver). The organization was founded in 2000 to serve as a national voice for our affiliate organizations. The CSTA is also affiliated with the Security Traders Association (STA) in the United States of America, which has approximately 4,200 members globally, making it the largest organization of its kind in the world.

This letter was prepared by the CSTA Trading Issues Committee (the "Committee" or "we"), a group of 21 appointed members from amongst the CSTA. This committee has an approximately equal proportion of buy-side and sell-side representatives with various areas of market structure expertise, in addition to one independent member. It is important to note that there was no survey sent to our members to determine popular opinion; the Committee was assigned the responsibility of presenting the views of the CSTA as a whole. The views and statements provided below do not necessarily reflect those of all CSTA members or of all members of the Trading Issues Committee.

We appreciate the opportunity to comment on the proposal by the TMX Group to modify the TSX Alpha Exchange trading model (the “Proposal”).

We applaud the TMX for proposing to reduce some complexity within the Canadian marketplace by decommissioning the IntraSpread facility and eliminating the opening auction for TSX and Venture-listed securities on Alpha. In conjunction with this proposal, we also would like to acknowledge the TMX’s indication that they will be decommissioning the TMX Select market; less fragmentation in the Canadian markets is generally acknowledged by the Committee as a positive development.

While we agree with some of the changes as presented, we have significant reservations about the proposed application of a processing delay or “speed bump” being applied to some orders before being executed or booked in Alpha.

The “Speed Bump”

As proposed, Alpha Exchange would subject orders entered to a randomized delay at the gateway level, prior to releasing the order to the trading engine. This delay, or "speed bump," would apply to all orders except those marked as Post-Only. This ensures that any and all orders that are taking liquidity will be subject to a delay. The existence of the speed bump is justified in the proposal as follows:

“The speed bump will discourage latency sensitive active strategies, regardless of the classification of the participant using the strategy, but will not deter active natural investor flow for which a delay in milliseconds is insignificant. This will facilitate for passive liquidity providers an increased likelihood for of interacting with active orders of natural investors, while protecting against opportunistic, latency sensitive active strategies.”

We disagree with this justification, as active investor flow that cannot be filled immediately and completely on Alpha will in fact be deterred. When handling a marketable order that is larger than the available liquidity on Alpha, an executing dealer will no longer be able to effectively “spray” orders across all marketplaces to capture liquidity across all markets. We will explain this situation below.

Conceptually, dealers will be faced with 2 scenarios:

> 1) “Spray” all markets and allow the possibility that passive orders posted on Alpha will be cancelled before they are filled. We note that the premise of the Alpha speed bump model is to encourage size provision on the basis of being able to cancel with impunity if market conditions change. The ability to cancel and "fade" orders is the core value proposition of the speed bump.

2) Route to Alpha first and take the chance that passive orders posted on other markets will be cancelled when they see a fill occur on Alpha. This implies that the speed bump not only discourages latency sensitive active strategies as stated, but also deters "large" orders (and thus many institutional and large-sized retail orders) from routing to Alpha.

We acknowledge that Alpha does propose to impose a minimum posting size in order to receive the benefits of the speed bump. To assuage the concerns above, we believe that the required minimum posting sizes would need to be significantly larger than the typical size of a retail order, and cover the majority of marketable parent orders handled by smart routers. It is not enough to judge an appropriate minimum size based on average trade sizes on various marketplaces, as trade sizes represent the lowest common denominator between sub-divided active parent orders (split by smart routers) and the resting orders entered by liquidity providers.

The TMX states that it believes that the proposed amendments will require minimal changes by participants and vendors. We strongly disagree with this statement. As described above, institutional dealers will have to design a routing strategy that is tailored to orders that are both larger and smaller than the available liquidity on Alpha to ensure that they are providing their clients with best execution. This will require a major overhaul of all existing SOR technology in Canada at a significant cost to the Street. This cost externality is imposed by TMX Group on marketplace participants with impunity, and the Street does not have recourse. As discussed in our letter in response to proposed changes to National Instrument 23-101, dated September 19, 2014, we believe such actions should be seen as an extension of a regulatory subsidy to protected marketplaces, and therefore subject to oversight and restriction by regulators.

The "Speed Bump" Encourages Liquidity Fade

The Proposal cites Aequitas Neo Exchange's speed bump for Latency Sensitive Traders (LST) as a relevant precedent in Canada. The Proposal further suggests that the Alpha speed bump would be applied on a more equitable basis since it would apply to all classes of participants.

Although Alpha does not propose to identify classes of participants, it does delineate benefits for participants that will choose to use Post Only orders (with a certain minimum size) versus all other order types in the market. Since the Post Only order type is technically available to any participant, their argument of a more equitable application of an existing approved feature is seemingly sound. However, the Post Only order is only broadly applicable to strategies that depend on being passive and are extremely sensitive to traded prices within the context of the NBBO. Post Only orders are also typically used in conjunction with two-sided market-making strategies that rely on spread capture. In other words, we do not believe that Post Only orders have meaningful utility to natural investors. On the contrary, the only users of Post Only will be those most likely to cancel and fade their orders when detecting conditions that suggest that the inside quote is about to change. The Proposal would turn Alpha into a market which structurally favors order cancellation. For this reason, we believe that quotes on Alpha should be deemed "unreliable" regardless of their size.

We believe that the value of the NBBO is put into question when it incorporates orders placed on a marketplace which encourages order cancellation and thus promotes orders being that are considered "unreliable" We recognize that "fleeting liquidity" is deemed a commonplace occurrence today; the Alpha proposal exacerbates the problem rather than improving it. Adding to the problem is Alpha's status as a protected marketplace, meaning that dealers will be required to access quotes on Alpha under the Order Protection Rule, however “unreliable” those quotes may be. Finally, with the existence of randomized speed bumps and built-in delays to smart order routing, the ability of dealers to develop appropriate SOR technology is greatly handicapped.

Finally, we note that strategies which enter orders that are not intended to be executed may create a false and misleading perception of liquidity on a marketplace. In particular, with Alpha's proposal designed to facilitate rapid order cancellation, this type of behavior may be enabled by the marketplace. We wish to call into question a marketplace mechanism design which promotes the rapid cancellation of orders and "unreliable" quotes. In our view, such a marketplace model is not consistent with just and equitable principles of trade.

Justification for the “Speed Bump”

In the TMX position whitepaper entitled “Reshaping Canada’s Equities Trading Landscape” (October 2014), the risk of Canadian order flow migrating to the US was indicated as a major motivation for the proposed changes to the Alpha model. Since US market structure allows for direct payment for order flow from wholesalers and order intermediaries, the TMX is attempting to deter dealers from routing Canadian active flow to the US by offering them a Canadian market destination that will lower their costs and present them with a posted size that could potentially replicate their experience with US counterparties.

The differences in Canadian and US regulations (fair access, payment-for-order-flow, minimum price improvement in the dark) make it impossible for any market in Canada to truly replicate the US trading experience for dealers with active retail orders. We believe the only means of ensuring that Canadian active flow is not systematically sent to the US is a regulatory barrier, such as the previously proposed dark trading anti-avoidance rule. We are not advocating such a rule at this time. However, we are skeptical that any commercial offering will be viable alternative to bilateral payment-for-order-flow arrangements between Canadian retail dealers and US wholesalers.

If an anti-avoidance rule were in place, dealers would then be forced to interact with Canadian markets, bearing the costs involved. This would impact dealers' cost structures, commission rates and business models. The Proposal aims to provide better economics for retail trading in Canada, with significant externalities for participants other than retail dealers. Approval of the proposal is equivalent to approving externalities that favour one business model over another, by providing a solution to retail dealers which may harm institutional dealers and clients. This is a dangerous decision in our view. If the cost of trade for retail dealers is the underlying issue, we believe the appropriate solution is to address the cost drivers directly, without imposing externalities which change the entire dynamics of the market.

Order Protection Rule not required for Alpha to Succeed

In industry discussions, we believe there is a common view that exempting quotes on Alpha (or any other marketplace with a speed bump) from the Order Protection Rule would resolve the issues with this type of feature. We acknowledge that allowing participants to circumvent the Alpha quote would alleviate some of the complexities for SORs. However, avoidance of Alpha's quotes by SORs would exacerbate the true problem of segmentation in our visible markets.

For Alpha to succeed in attracting passive liquidity, the providers of liquidity must be able to avoid adverse selection from large active orders. If OPR were relaxed, many SORs would avoid Alpha (especially with large orders) and thus provide the specific conditions to successfully create a market where mostly small (retail) orders would be routed. This would mechanically separate large orders from small and promote order segmentation in lit markets.

While we would prefer that the proposed speed bump be disallowed completely, we would also strongly caution against providing an exemption to OPR without considering the consequences of structurally enabled order segmentation. If OPR remains in force and SOR providers are forced to adapt to Alpha, the value proposition of Alpha to liquidity providers will weaken and counteract the potentially negative effects that would be created by further facilitating systematic order segmentation in our market.

Conclusions

In our response to the Application for Recognition by Aequitas Neo Exchange, dated September 5th, 2014, we noted:

> *Some members also expressed a concern that the type of segmentation that is being proposed may set a precedent to segmentation in the lit markets by the nature of the strategy or type of investor (for example, retail vs. institutional). Under the same logic, another protected market could theoretically impose constraints limiting the speed of institutional order flow instead of LST order flow, allowing participants protection from being adversely selected by large orders.*

The Alpha proposal represents precisely such segmentation. Any decision to approve or deny the application must rest on whether a market model which bifurcates retail flow from institutional flow is appropriate in the spirit of fair access. We believe that the Alpha proposal is prejudicial against large orders, and for this reason must be viewed with skepticism.

Finally, we believe that allowing Alpha to move forward with its proposal to implement a speed bump is another step towards allowing the NBBO to lose its validity and meaning, systematically allowing for “fleeting liquidity”. We maintain our deep concern for the integrity of the market, since the Alpha proposal will lead to an NBBO that is not equitably accessible for all participants.

For the above reasons, we would recommend that the Alpha proposal be deferred pending further industry discussion on the topic of retail order execution in the context of the US wholesaling model.

We appreciate the opportunity to comment on this matter.

Respectfully,

"Signed by the CSTA Trading Issues Committee"

c.c. to:

Ontario Securities Commission:
Mr. Howard Wetston, Chair and CEO
Ms. Maureen Jensen, Executive Director & CAO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

Alberta Securities Commission:
Ms. Lynn Tsutsumi, Director, Market Regulation

Autorité des marchés financiers:
Me Anne-Marie Beaudoin, Secrétaire générale

British Columbia Securities Commission:
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