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Securities Commission of Newfoundland and Labrador
Superintendant of Securities, Northwest Territories
Superintendant of Securities, Yukon territory
Superintendant of Securities, Nunavut
Superintendant of Securities, Prince Edward Island

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FOR THE INDUSTRY. BY THE INDUSTRY.

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Re: Comments on March 18, 2011 Amendments to NI 21-101 and 23-101

For Your Consideration:

We acknowledge that market structure as well as the role of various market participants including marketplaces has changed since the original NI- 21-101 and 23-101 were adopted ten years ago and commend the CSA for trying to achieve the objectives of consistency, streamlining, and greater transparency regarding how marketplaces operate. While we support many of the changes, we have some concerns that the changes have unintended consequences because they are not consistent with the original structure and intention of the rules which included facilitating innovation and choice, while streamlining regulatory oversight.¹

This comment letter will set out our understanding of the original context of the rules as background to our comments on the amendments followed by specific comments on the various proposed changes. Our key points are:

1. Alpha supports transparency but urges a more streamlined processing of proposed changes.
2. Duplication of oversight should be eliminated wherever possible.
3. Alpha supports the collection of data for analysis and identification of issues; however requests that data collection efforts not be duplicated if the information is easily available from IIROC.
4. Alpha agrees that all marketplaces should support fair and orderly markets, but requests that the regulators enable the marketplaces to have the tools to fulfill that responsibility.
5. Delegating the decision regarding minimum order size for dark pools to IIROC is premature and creates uncertainty.
6. No explanation has been provided why the current thresholds are not appropriate.
7. Alpha supports public disclosure regarding marketplace operations.
8. No current problems have been identified to support the significant policy change of extending the interpretation of marketplace to traditional dealer activity.
9. Alpha supports holding marketplaces responsible for intentionally locking or crossing markets but believes the guidance set out in the Companion Policy goes beyond intentionally locking, and includes unintentionally locking or crossing a market.

¹ In addition, it may be more beneficial to reconsider the structure and make changes to reflect the more fundamental changes such as the universal adoption of UMIRS and deference to IIROC as the market regulator. These changes are fundamental because the regulatory role of exchanges has to a large extent been replaced by the IIROC and the application of UMIRS to all marketplaces. One could even question whether exchanges carry out a public interest function in Canada anymore.

Original structure for regulation of marketplaces

The original rules recognized that technology had increased the commoditization as well as fragmentation of trading into different liquidity pools; and thereby blurred the lines between dealers and exchanges. NI 21-101 was intended to address potential regulatory gaps as well as the duplication of oversight by allowing marketplaces (where there was the electronic bringing together of multiple buyers and sellers) to choose to be regulated as:

- A dealer if it was participant in an exchange;
- A dealer with specialized transparency, access and operational requirements (dealer plus) if it was not a participant in an exchange, and not supporting market making and listing, nor providing a rulemaking function (creation, monitoring and enforcement of rules); or
- An exchange.

IIROC was intended to be the primary regulator with oversight responsibilities for the dealers or dealer plus models and the securities regulators were intended to be the only regulator for exchanges.²

Amendments to Regulatory and Reporting Requirements with respect to changes

1. Alpha supports transparency but urges a more streamlined processing of proposed changes.

While there are differences between ATs and exchanges, there are also many similarities in terms of trading functionality. We agree therefore that it is appropriate to support transparency by making the requirements for review and comment for all marketplaces similar for material changes regarding types of orders, allocation of priorities and other functionality regarding price discovery. We believe however that the process should be streamlined as much possible and focus solely on market integrity issues and not competitive issues.³

We commend the CSA for allowing an expedited process (7 days as compared to 45 days) for fee changes which is in line with greater efficiency⁴.

While the proposed amendments suggest that there will be a 45 day period including a comment period for significant changes, the guidance for significant changes is very broad. We note that many regulators have recognized that the pace of change and competition to innovate require more efficient processing

² Over time and through practice, the alternative trading systems that chose the dealer plus model have had dual oversight by both OSC and IIROC.

³ It has been our experience that much of the comments on proposed changes come from competitors and are focused on commercial issues. Moreover it is not uncommon for a marketplace to adopt a particular new functionality after it has submitted a negative comment against its deployment by a competitor.

⁴ The original requirements for ATs were intended to provide a type of self-certification process for material changes only. The broad interpretation by the CSA has impeded Canadian marketplaces' ability to be responsive and innovative and added unnecessary burdens. An example is that currently a marketplace is required to give 45 days' notice if it wants to change its start of day from 4 a.m. to 5 a.m.

of changes (especially those that do not involve market integrity as compared to market quality) and have moved to self-certification of changes subject to after the fact reviews⁵.

In order for the Canadian capital markets to be competitive with other markets we believe that the review and comment process should be limited to the following categories: material changes to the market structure, material changes to the types of participants, material changes to market surveillance and enforcement for exchanges, and material changes to governance for exchanges. All other changes should be filed as part of the Quarterly Filing process. If a marketplace mischaracterizes a change it could be penalized by reversing the change or some other sanction available to the regulators.

In addition, all marketplaces should be required to publicly post descriptions and rules or policies describing how the marketplace operates including order types and trading allocations. We therefore support the amendments to Section 10.1.

2. Duplication of oversight should be eliminated wherever possible.

The fundamental issue of the allocation of responsibility for oversight of ATSS has not been considered as part of these amendments and raises questions regarding the role of IIROC in its oversight of ATSS. It also indicates that there is likely to be unnecessary and burdensome dual oversight by both IIROC and OSC.

Amendments regarding Data Reporting (F3)

3. Alpha supports the collection of data for analysis and identification of issues; however requests that data collection efforts not be duplicated if the information is easily available from IIROC.

The amendments added reporting requirements with respect to certain order types, crosses, concentration of trading by marketplace participants, other services such as routing and co-location, and system information. While we commend the regulators for collecting data for use in both oversight as well as policy making, we question whether the best source of this information is the marketplaces or whether this is a duplication of information already being collected by IIROC. Since the purpose of collecting this information by the regulators is not clarified and considering it will be costly for the marketplaces to produce this information; we believe a cost benefit analysis should be performed to validate which information is necessary and what the best source for the information would be.

Amendments regarding Marketplace Rules

4. Alpha agrees that all marketplaces should support fair and orderly markets, but requests that the regulators enable the marketplaces to have the tools to fulfill that responsibility.

⁵ Self-certification has been adopted in Canada regarding the derivatives markets and is equally applicable in the securities markets.

The amendments add requirements for ATs to avoid in engaging in any activity that would interfere with the maintenance of fair and orderly markets which is described as fair access, transparency regarding operations, and procedures to manage conflicts of interest.

We agree that all marketplaces have responsibility for market quality and that, in addition, exchanges also have responsibility for market integrity to the extent of their rule making and enforcement functions. However in order for marketplaces to be able to fulfill those responsibilities they must have the tools to do so (appropriate responses as well as appropriate requirements). While this may lead to some duplication with activities performed by IROC and the securities regulators, it provides additional investor protection as well.

The issue of the tools is not directly addressed in the amendments; moreover some provisions in the amendments even suggest that marketplaces should not have tools. For example, to support market quality a marketplace should be able to cancel trades. This is not the regulators' current position. It is neither meaningful nor fair to impose requirements upon marketplaces without allowing them the tools required to achieve their responsibilities.

Amendments regarding Information Transparency

5. Delegating the decision regarding minimum order size for dark pools to IROC is premature and creates uncertainty.

The policy debate on dark orders and facilities appears to have been finalized through the proposed amendments. The amendments introduce a requirement to allow a Regulatory Service Provider (IROC) to set a minimum size threshold for dark orders. We still believe there is no conclusive data supporting the need for any regulatory action at this time, and that this language leaves a great deal of uncertainty and a potential chill on innovation that will be detrimental to market quality.

Threshold Notifications

6. No explanation has been provided why the current thresholds are not appropriate.

The current requirement to provide notification of reaching a threshold volume is being decreased from 20% to 10%. Alpha questions why this is being done and what it will achieve since most of the requirements for exchanges and alternative trading systems will be the same. We would note that Alpha has been operating for over a year at above the 20% threshold without any issues. The change would place an additional burden on the ATs without any clear benefit.

Transparency of Marketplace Operations

7. Alpha supports public disclosure regarding marketplace operations.

Alpha supports the amendments that require public disclosure regarding access, securities traded, orders, how orders interact and other trading functionality⁶.

Definition of Marketplace

8. No current problems have been identified to support the significant policy change of extending the interpretation of marketplace to traditional dealer activity.

The amendments have added “clarification” in the Companion Policy stating that a dealer using “a system that brings together multiple buyers and sellers using established, non-discretionary methods to match or pair orders with contra-side orders outside of a marketplace and which generates trade execution through the routing of both sides of a match to a marketplace as a cross” would be considered to be operating a marketplace.

Alpha has concerns about this change since the purpose and application of these changes are not clear and could have significant unintended consequences. The original NI 21-101 was crafted to leave in place traditional activity of the dealers while providing for new types of entrants. While it is true that the use of technology has increased and that automated functionality has been extended, a dealer using technology to implement discretionary responsibility should not lead to the transfer of the fundamental role of a dealer as a market intermediary into a marketplace.

Furthermore, the breadth of the consequences of these changes could be to eliminate a dealer’s ability to internalize flow and is a significant policy change that should be highlighted and debated. We would also point out, that forcing the dealer into being treated as an ATS has another impact which would be to remove a dealer’s best execution obligation to its clients because as an ATS it is exempted from that obligation. We also believe that the significance of this issue requires that a more substantive cost benefit analysis be done.

Locked and Crossed Markets

9. Alpha supports holding marketplaces responsible for intentionally locking or crossing markets but believes the guidance set out in the Companion Policy goes beyond intentionally locking, and includes unintentionally locking or crossing a market.

The amendments apply the obligation to marketplaces to not “intentionally lock or cross a market when it routes or reprices orders.” A marketplace or a dealer should only have to check at the time of routing orders and should not be responsible if pegged orders including short sale orders that sit in the book cause the situation because the reference price has changed. Extending the protection to these situations discourages the use of pegged orders.

⁶ We would like to note that any conflicts policy should be expected to balance commercial interests of all parties including the marketplace itself.

The regulatory purpose for imposing a restriction against locked or crossed markets was mainly to prevent those who relied on rebate strategies to ignore other markets in order to post resting orders. The interpretation goes beyond this policy purpose. Since this interpretation has significant technology implications, we believe that a cost benefit analysis should be done before extending the application of the restriction to orders that respond to changes in the NBBO or other reference prices without any mal-intent.

Sincerely,

A handwritten signature in black ink, appearing to read "Randee Pavalow". The signature is fluid and cursive, with the first name "Randee" and last name "Pavalow" clearly distinguishable.

Randee Pavalow
Head of Operations and Legal
Alpha ATS LP