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May 13th, 2013

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and

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Re: Alpha Exchange Inc. – IntraSpread Trading Fee Model Amendment – Notice of Proposed Fee Change and Request for Comment

The Canadian Security Traders Association, Inc. (CSTA), 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 traders 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: a group of 20 appointed members from amongst the CSTA. This committee has an equal proportional number of buy-side and sell-side representatives with various areas of market structure expertise. It is important to note that there was no survey sent to our members to determine popular opinion; the Trading Issues Committee was assigned the responsibility of presenting the opinion of the CSTA as a whole. The opinions and statements provided below do not reflect the opinions of all CSTA members or the opinion of all members of the CSTA Trading Issues Committee.

The CSTA appreciates the opportunity to comment on the proposal by Alpha Exchange Inc. ("Alpha") to offer differential pricing for fills in the visible (lit) market depending on whether or not the active side of the trade is a Seek-Dark-Liquidity ("SDL") order available to "retail" participants only. The current proposal mirrors the feature set originally proposed by Alpha Exchange Inc. on July 26, 2012: fills in the Alpha lit book resulting from SDL active orders would receive a differential rebate and the nature of the counterparty would be disclosed to the passive participant. The CSTA commented on this proposal on August 27, 2012. The views expressed in the original response remain relevant and have not changed.

We wish to highlight that the given proposal seems to be a de-facto restatement of the prior proposal which Staff have addressed in a Notice of Approval on October 5th, 2012. In our opinion, prior commentary on the July 26th, 2012 IntraSpread proposal should serve as a precedent for the proposal at question now. Nevertheless, the CSTA wishes to reiterate its views on this matter.

General Remarks

We believe that it is very important that the definition of a "retail" client be made fully transparent to all participants, as it is critical to the IntraSpread model. As highlighted in a CSTA letter to the OSC dated March 2, 2012, the only available definition of "retail" – that which is referenced in the Alpha Exchange trading policies – is that a participant must not be an "Institutional Customer", based on the IIROC definition. Additionally, there has been no disclosure (that we know of) by Alpha to outline the procedure determining whether or not a client is deemed as "retail", nor if there is a systematic pre/post trade audit in place to determine the adherence to the definition. Considering that the proposal wishes to allow "retail" clients to interact with the visible markets at a discounted rate over all other participants, we are concerned the lack of specificity in the process. Is Alpha simply relying on each broker's interpretation of "retail" to determine which orders can be marked as SDL? We respectfully ask that prior to additional changes being made to IntraSpread, that the definition of "retail" be clarified. Moreover, we are concerned that the technical limitations of Alpha – the inability to specify that an order is "retail" on an order-by-order basis – means that the order flow pipes that share retail and non-retail activity for legitimate reasons may be unfairly treated.

We are also concerned with the fact that there has been no disclosure to date regarding the actual proportion of participants in the Canadian marketplace that can be defined as "retail" under the current definition. We do not have accurate metrics for what the percentage of the average daily volume this group represents, or how these participants are distributed amongst dealers. This lack of transparency makes the task of providing an "informed" commentary significantly more complex.

The Proposal seeks to offer differential fees for SDL flow - a reduced take fee for the active participant and a reduced rebate to the liquidity provider. The main rationale for the proposal is as follows:

> *Wide adoption of IntraSpread by the liquidity providers was based on the economic incentives that liquidity providers could derive from providing liquidity to **natural investors**, while being able to trade exclusively with retail order flow and not with other **informed participants**.*
>
> *The same low-incentive approach does not work in marketplaces where access is open to all participants and under the same conditions. The limited success of lit marketplaces with low rebates provides evidence that rebates are a necessary incentive and risk protection mechanism for liquidity providers when trading against a mix of informed and uninformed flow.*

Since the Proposal hinges on the above argument, we believe that it is also important to clarify the definition of the following terms:

1. "Natural investor": We are not familiar with a technical definition of this term. We would ask that any proposal that relies on such a term also provide a clear definition of what is intended.
2. "Informed participants": We ask that this term also be defined. We would also highlight that given the prevalence of activity among high net worth "retail" individuals, some retail flow may in fact be considered similar in nature to institutional flow – and be similarly "informed" (however defined).

Fair Access

In our opinion, it is inappropriate to offer differential pricing for precisely the same fill in the lit market depending on the nature of the counterparty. With smart order routers currently being configured with a view towards managing execution costs, the net execution price of a resting order in the Alpha lit market will vary with the nature of the active participant. A participant may wish to pay $10.00 for shares of a security given a reduced (retail) take fee, but not at the regular non-retail take fee. In essence, the differential price prejudices the Alpha lit book against non-retail participants who are forced into paying higher rates for precisely the same fill as would be offered to a retail liquidity-seeker.

We believe this problem is exacerbated in the case of institutional investors managing what is ultimately "retail" wealth. Though the majority of institutional investors do not yet, in most cases, directly capture marketplace fees/rebates, it is certainly a framework that is being considered in an environment of low volumes, commission reduction and ever growing costs relating to technology expenditures. If an institutional investor were using a direct fee/rebate transfer structure, they would be subject to the higher take fees directly rather than paying all-in commissions to their executing brokers. This fee would therefore be borne by fund unit holders which represent by far the largest proportion of wealth of the Canadian public.

Finally, the proposal by Alpha to disclose the nature of the counterparty (retail or non-retail) either directly or by implication via the amount of passive rebate raises additional concerns. This information would not be available to any participant other than the trade counterparty – regardless of whether the dissemination is immediate or delayed. We believe this places the passive participant who is party to the execution in a privileged position of having information not broadly available as compared to other passive participants that are present at the time. We believe that this is prejudicial against liquidity providers who have yet to receive a fill. For instance, if a passive participant that is offering a security is filled by an order which is deemed non-retail, they may elect to cancel their remaining offers on the basis of this information. The remaining offers in the Alpha book would not have the opportunity to act on the same rationale and may be disadvantaged by comparison.

Leakage of Information

The CSTA continues to be extremely concerned by the aspect of the proposal wherein Alpha would disclose the nature of the trade counterparty (retail or non-retail) to the liquidity provider. This concern was discussed extensively in our submission on August 27, 2012. In the prior letter, we asserted:

We believe that under the proposed structure of IntraSpread, certain intermediaries with orders on Alpha will have an unfair knowledge of the nature of the flows simply by receiving a fill. Indeed, a trader with an order in the lit market (eligible to interact with any market-bound flows) will know with certainty whether they traded against an SDL retail order or not. If the market bound order is deemed retail, it is likely "done". If it is deemed not retail, then it is more likely to be an institutional order, hence larger, and more likely to result in additional flows in the same direction. We believe this is both material and non-public information about the nature of the trade.

Our views today are consistent with the above. Rather than restating our position, we wish to refer Staff to the complete argument expressed in the August 27, 2012 letter.

Upon further review and consideration, we wish to amend our views on the delayed disclosure of fill and rebate information to passive participants. We believe that any trade-by-trade disclosure would raise the same information leakage concerns, with delayed disclosure being less harmful than immediate disclosure. Nevertheless, in some instances – such as activity in illiquid securities – the presence of non-retail flow may be indicative of directional multi-day orders and allow some participants to construct a mosaic of institutional activity. Moreover, given that Alpha is a protected book under the Order Protection Rule, there would be no way for institutional participants to "opt out" of trading on Alpha on the basis of this risk of leakage. From the perspective of the active participant, there is no commensurate benefit to the information being provided.

Conclusion

In our August 27, 2012 letter, we concluded:

Ultimately, the existence of IntraSpread, and in particular the existence of the retail identification tag, is a byproduct of the make-take fee model prevalent in Canada today. We believe that the distortions created by make-take billing, and the resulting emphasis on managing the cost of trading for retail brokers in particular, are the underlying cause for concern. The actuality of IntraSpread showcases the perceived need for different fee structures for retail and non-retail flow and thus cannot be fully addressed without also reviewing the make-take fee structure in its entirety. We understand that such a review is forthcoming and we look forward to contributing to the Commission's efforts in this area.

Our views today are consistent with these conclusions.

We appreciate the opportunity to comment on this matter.

Respectfully,

"Signed by the CSTA Trading Issues Committee"

c.c. to:
OSC:
Mr. Howard Wetston, Chair and CEO
Ms. Maureen Jensen, Executive Director & CAO
Ms. Susan Greenglass, Director, Market Regulation
Ms. Tracey Stern, Manager, Market Regulation

IIROC:
Ms. Susan Wolburgh Jenah, President and CEO
Ms. Wendy Rudd, SVP, Market Regulation & Policy
Mr. James Twiss, Vice President, Market Regulation Policy
Ms. Deanna Dobrowsky, Vice President, Market Regulation Policy
Mr. Mike Prior, Vice President, Surveillance