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Comments Regarding the Alpha Exchange Inc. Proposed Rule Amendments

Markets have evolved with increasing technological, sophistication and fragmentation. Competition for order flow has resulted in haphazard responses. High Frequency Traders ("HFTs") with a speed advantage, enabled by the Toronto Stock Exchange and other Canadian marketplaces, dominate trading in the active Canadian listed securities today. This situation, without any marketplace managing it, is in our opinion the Achilles heel of our capital markets and exposes investors to unfair taxation, unreliable liquidity and technology glitches. We believe this exposes dealers to an ever increasing cost of doing business, and public companies to erratic price fluctuations and degrading liquidity if they are not part of the actively traded few. Maison Placements Canada Inc. ('Maison') believes that the TMX Group needs to do more for the long-term investor, dealers and, ultimately, public companies. Instead, they appear to be doing more and more to the benefit of HFTs.

We understand that the Ontario Securities Commission (OSC) is listening to the concerns of the Street over the quality of our markets and are strongly encourage them to support initiatives addressing the issues in our markets. What they should not do, is support TMX proposal for its Alpha trading platform.

Legalizing the US Wholesalers model in Canada?

TMX has positioned its changes to the Alpha trading platform as a response to the threat of order flow, specifically retail order flow, migrating to the US and, in addition, they pretend it will help tackle certain predatory HFT behaviours. Wrong.

The movement of Canadian order flow into the US is mainly driven by economics (i.e. the 'payment for order flow" provided by US wholesalers). Canadian retail dealers are incentivized to send US wholesalers their marketable retail orders and they generate revenue on the back of it. There are a lot of concerns about this model and how it ensures that the best interests of the retail investor are taken into account. This concern has been demonstrated through the recent developments in the US, including a class action lawsuit regarding how retail dealers set up their routing preferences and utilize wholesalers.

The solution the TMX proposes through Alpha to counter the threat of US wholesalers is the combination of 1) a speed bump that will be applied to everyone, except those utilizing the Post Only order type; 2) inverted pricing; and 3) a minimum size requirement for Post Only.

In other words, the TMX is proposing to introduce in Canada a model similar to the US wholesalers model. They plan to incentivize dealers, through the inverted pricing structure, to send their marketable orders to the TMX Alpha platform. This is payment for order flow ("pay for play")– a key characteristic of the US wholesaler model.

By applying a speed bump to everyone with the exception of the Post Only Orders, the liquidity providers on the TMX Alpha platform will only be co-located HFT firms. Who else uses Post Only orders? It is an order that gets cancelled upon entry if it were to trade. This means there will be a select number of firms leveraging their technology and, in Canada, internalization, to trade marketable orders. Yet another characteristic of the US wholesalers model.

Finally, by applying the speed bump to everyone else, we can expect that marketable institutional orders will avoid the TMX Alpha platform, as the more sophisticated institutional investor knows that the TMX Alpha platform enables HFTs to detect their orders on other platforms and will adjust their liquidity providing orders accordingly. This means that mainly marketable retail orders will be sent to the TMX Alpha platform, the last key characteristic of the US wholesalers model. The sole difference between the TMX Alpha model and the US wholesalers model is that in the latter, retail order flow can at least get a price improvement, but it will be meaningless.

At Maison, we firmly believe that if the TMX puts in place this full replication of the US wholesalers model, it will solely benefit HFTs and allow them to deploy predatory strategies, enabled and protected by TMX. Orders sent there will be on behalf of the least sophisticated investors – the retail investors – and they will be exposed to predatory trading strategies. Institutional order flow will actively try to avoid this platform, leading to yet more order flow segmentation in the Canadian markets. We can anticipate the implications of this from a price discovery and quality of execution perspective. We can also expect institutional flow, fully segmented from retail order flow, will have less interest to trade in Canada and migrate in a more substantial way to the US. This will nullify any benefit of more retail flow staying in Canada.

While the TMX Alpha proposal may be beneficial to the large retail dealers seeking to maximize revenue out of what they themselves call the “dumb” retail order flow, it goes against all the principles Canadian regulators have always stood for, even as recently in the 2011 CAS and IIROC Staff Notice about dark liquidity.

The fact that TMX even proposes this solution and that out for public comment without debate and questions is worrisome. Maison does not believe that many market stakeholders understand the consequence of this proposal due to the misleading information that was published by the media, and not corrected, upon its announcement.

Reducing Market Complexity – to What End?

TMX is also proposing to reduce complexity, fragmentation and dealer costs by closing down TMX Select. At Maison, we believe it is a positive move for the TMX to reduce the number of markets they operate when there is no added value in comparison to what is already offered. That said, the decision to shut down Select, instead of Alpha, doesn’t minimize the impact on the core market users. On the contrary, it comes with additional costs which could easily have been avoided.

TMX Select had already migrated to the new TMX technology platform and is operating with an inverted price model. In fact, Select is much closer to the “new” Alpha than the “current” Alpha. Making the proposed changes to Select would have been much easier and less costly for market users. Instead, the TMX is forcing the industry to go through yet another costly technology migration driven by their own benefits, like preserving the market data revenue generated by Alpha. This does not help the core users, on the contrary.

Maison Placements Canada Inc.

Maison Placements Canada Inc. is an independent, Toronto-based investment dealer providing a comprehensive array of financial services to institutional investors and small to midsize corporate clients. Founded in 1955, Maison has established a reputation of providing Corporate Canada with high quality strategic investment banking advice and access to sources of financings. The heart and strength of the company is research, a small team of specialists providing both research and expertise. Maison has been able to execute successful financings, mergers, and acquisitions. Maison is also a shareholder of the TMX Group.

Best regards

John R. Ing
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