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## **RE: ALPHA ATS LP: NOTICE OF PROPOSED CHANGES AND REQUEST FOR FEEDBACK**

### **SUMMARY**

CIBC World Markets Inc. ("CIBC WM") appreciates the opportunity to comment on the proposed IntraSpread™ facility of Alpha ATS LP.

Although CIBC WM does not generally support the integration of dark and lit books, we believe that IntraSpread is sufficiently segregated from the visible Alpha book to be viable as a dark pool despite being operated within the structure of the same ATS.

We believe that, as described, the facility will operate more as a third party internalization engine rather than a proper dark pool, and do not have any concerns around this. We believe that the internalization activity enabled by this facility is common practice today, and that Alpha is simply commoditizing technology to offer dealers an alternative to building and operating their own costly internalization systems.

However, CIBC WM has serious concerns around potential functionality not directly addressed in the notice, and around the next evolutionary phases of the IntraSpread facility. Specifically, we are concerned that IntraSpread will enable counterparty selection in trading, either upon launch through the "internalization" of jitney orders from other dealers, or in the future through the addition of an exclusionary matching leg within IntraSpread. Although the notice does not imply that either of these scenarios will come to pass, we note that they are not specifically excluded either. We would request that Alpha specifically address these two concerns in its response.

CIBC WM believes that if IntraSpread evolves beyond an internalization facility, it should be towards a proper dark pool with communal matching, rather than devolving towards an exclusionary facility that resurrects the unfairness and inefficiency of dealer markets of the past.

### **DETAIL**

We believe that the IntraSpread facility, and related order types described in the Alpha notice, are aligned with the dark pool principles detailed in CIBC's submission to the OSC<sup>1</sup>, provided that IntraSpread will not permit Dark or Seek Dark Liquidity orders that are jitney orders for another broker. Specifically:

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<sup>1</sup> "Response to Consultation Paper 23-404", CIBC World Markets Inc., December 29, 2009, [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_com\\_20091229\\_23-404\\_parkhill\\_climo.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_com_20091229_23-404_parkhill_climo.htm).

<b>CIBC Principle/Opinion</b>	<b>IntraSpread Proposal</b>
<i>The interaction of dark orders with visible limit orders is beneficial to the market, provided that dark orders bearing discretionary prices are constrained to dark pools in order to maintain the tradeoff between price and immediacy.</i>	Dark orders interact with SDL orders, which are IOC representations of orders destined for the visible market. Because any residual quantity remaining after the IntraSpread stage is cancelled back to the originating router, which will then investigate all visible books fairly, IntraSpread behaves like a segregated dark pool and maintains the tradeoff between price and immediacy.
<i>Allocations of trades at marketplaces should be based on price then visibility, with visible orders receiving priority at any given price level</i>	IntraSpread guarantees price improvement over the CBBO, which includes Alpha's visible quotations, so visible orders cannot have a better or equivalent price than Dark orders.
<i>All individual orders – whether they are visible or hidden – should bear a single price at a single moment in time</i>	IntraSpread Dark Orders bear a single price that is pegged to the CBBO. Although it is deterministic and constantly changing, the order only bears a single price at any single moment.
<i>The only dark order types that should be permitted on visible markets are those that are deterministically priced... or those that bear a discretionary price but reveal at least a portion of their size</i>	IntraSpread Dark Orders are deterministically priced using an algorithm that assigns a price that is inside the CBBO. Furthermore, they are not integrated with the visible book in any way.
<i>Fully hidden, deterministically priced orders ... should be permitted provided they are priced inside the NBBO</i>	IntraSpread guarantees at least 10% price improvement over the NBBO, ensuring all trades are priced inside the NBBO.
<i>All orders should [continue to] be permitted to execute at sub-tick prices, and visible quotations should continue to be limited to full-tick increments.</i>	IntraSpread executes in sub-penny increments, but does so in a segregated dark pool with no displayed quotations.

CIBC WM has no objections to IntraSpread as a strict internalization facility, provided jitneys are not permitted, as discussed below. In addition to addressing this concern, we request that Alpha provide additional detail on the specific allocation rules within the facility. That is, if there are two resting Dark orders bearing the same limit available to the SDL order, which will be filled first? Will the fills be allocated in time, volume, or some other priority?

Because the proposed functioning of the Alpha IntraSpread facility, as described in the submission, is aligned with the principles laid out by CIBC WM in its dark pool submission, we are supportive of the initiative. However, CIBC WM is concerned about the potential evolution of IntraSpread in the future, which has not been described in the submission.

### **CONCERNS WITH COUNTERPARTY SELECTION**

Once the IntraSpread facility is established as an internalization mechanism, and some amount of liquidity is aggregated there, two natural evolutions may follow.

The first, beneficial evolution would be for the facility to expand to provide “community matching”. In such a structure, flow that was not internalized would be exposed to the Dark orders of other dealers before being passed on to visible markets. This creates value in the marketplace because it maximizes potential price improvement for Seek Dark Liquidity (SDL) orders, and improves the fill probability for both Dark and SDL orders. These benefits could be further enhanced by permitting the Dark resting orders to interact with one another in a predictable way.

The second, detrimental evolution would be for the facility to expand to provide “counterparty selection”. In such a structure, flow that was not internalized would be exposed to a *select*, pre-determined group of other dealers’ Dark orders, as determined by the dealer issuing the SDL order. For example, if broker A offered 20% of a 1 tick spread in price improvement to broker B’s retail flows in the IntraSpread facility, the clients of all other brokers would lose the opportunity to trade against that quote. On the visible market, broker A would have had to improve the quote by a full tick to ensure interaction with broker B’s retail flow. Furthermore, if broker C offered a 30%

price improvement in the IntraSpread facility, broker B's clients would lose a potential opportunity to trade at a better price because they were forced to trade against broker A due to the preferential relationship.

Counterparty selection could be achieved immediately in IntraSpread, if the facility permits internalization of jitney orders. One broker could simply jitney through another in order to access their dark "quotes" in IntraSpread, and the liquidity supplying broker could control who is and who is not permitted to jitney.

Alternatively, counterparty selection could be achieved in the future by enabling bi-lateral relationships within the mechanisms of the IntraSpread book, paralleling a similar structure in Europe - the PartnerEx facility of the Equiduct<sup>2</sup> trading platform. Equiduct PartnerEx allows two counterparties to establish an exclusive commercial relationship, where one will act as exclusive market maker for the other, guaranteeing some level of price improvement that is not available outside of that specific relationship. Only the exhaust flow remaining after the selected counterparty has taken their turn to fill against the SDL would reach the visible to interact with other dealers' flows.

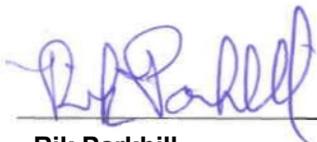
Although it can be said that IntraSpread internalization is simply a third party automation of a current accepted practice, permitting dealers to control who they trade with would be a new practice which is not available to dealers today. Exclusionary trading is detrimental to the efficient functioning of markets, as was most recently illustrated in the "FLASH" order controversy which centered on "first looks" at order flow and preferential distribution of client information<sup>3</sup>. Most regulation in Canada, the United States, and Europe has been aimed at reducing selective information disclosure and selective access to order flow.

CIBC WM would strongly oppose any features at IntraSpread or any other dark venue that would permit dealers to select their counterparties after the internalization stage, and believes that internalization should be limited to the matching off of orders within a single dealer. Instead, we encourage the evolution of IntraSpread towards a community matching model that maximizes the probability of finding price improvement, or size, for all participants. We also continue to look forward to clarity from IROC and the CSA around sub-penny (partial tick) price improvement.

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Thank you for issuing the Notice of Proposed Changes and Request for Feedback. Please feel free to contact us with any questions or requests for clarification.

Yours truly,



**Rik Parkhill**  
Head of Capital Markets Sales and Cash Equities  
CIBC World Markets Inc.



**Chris Climo**  
Vice President and Head of Institutional Compliance  
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<sup>2</sup> <http://www.equiduct.com/market-model/partnerex-and-internaliser.asp>

<sup>3</sup> Market Structure Briefing Note #2, "FLASH NOT MADE IN CANADA", CIBC World Markets Inc., July 29, 2009, and Market Structure Briefing Note #4, "IOIs Not a FLASH in the Pan", CIBC World Markets Inc., September 14, 2009.