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Nova Scotia Securities Commission  
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**RE: JOINT CSA/IROC – POSITION PAPER 23-405 – DARK LIQUIDITY IN THE CANADIAN MARKET**

Dear Sirs / Mesdames:

CIBC World Markets Inc. ("CIBC WM") appreciates the opportunity to comment on the impact of dark liquidity in the Canadian market. As a leading agency broker, we have had a great deal of interaction

with dark liquidity in Canada and the United States on behalf of our institutional, retail and electronic customers. Market innovations deliver benefits and introduce risks to the best execution of order flow from each of these constituent groups. We have significant experience in navigating the risks and rewards of dark liquidity, which we are pleased to share with IIROC and the CSA, through this comment paper.

Over and above our comments on the proposed guidelines, we would like to highlight what we believe to be an absolute necessity to the implementation of any dark trading regulation, which is compliance with **Fair Access** rules. Regulations should be focused on ensuring broad accessibility to dark pools and to the liquidity that resides in them. Counterparty selection or "selective preferencing" as a result of imposed regulation is an unacceptable model. The one-sided nature of the proposed rule permits the setup of an ATS where only select participants can post dark liquidity.

Though we commend the regulators for providing guidance on the use of dark liquidity, and exploring the risks of its expanded use, fundamental to our position is a belief that the existing regulatory framework has allowed for dark pools to be well integrated into the Canadian marketplace. Artificial constraints on a structure that provides real value to the market will create missed opportunities and reduce efficiencies.

New regulatory initiatives without clear evidence of a problem should be avoided. These prescriptive rules mandate major commonality across all markets thereby hampering the ability for competitive differentiation.

**Question 1) Under what circumstances should Dark Pools or marketplaces that offer Dark Orders be exempted from the requirements of pre-trade transparency under NI 21-101?**

***"The only exemption to pre-trade liquidity should be for orders that meet a minimum size threshold." – CSA/IIROC Recommendation***

We are of the view that there should be no minimum size requirement imposed on dark liquidity. The introduction of size thresholds for dark orders should remain at the discretion of a marketplace. Furthermore, the decision on the appropriate size of an order should remain at the discretion of the market participant executing an order, in their capacity to satisfy best execution obligations.

Users of dark pools do so for a purpose, taking into consideration the risks and rewards of such order placement. Placing a size restriction on dark orders will have the negative consequence of restricting many orders from participating in the dark. Orders should not be disadvantaged by regulation because they are not of sufficient size to participate, such as retail or algorithmic order flow. Forcing smaller orders to post on visible markets unfairly limits their available execution options.

Imposing a minimum size makes the improper assumption that markets, marketplaces and market structure are static. Given this is not the case, the selection of an appropriate size threshold today may not be optimal at another time. Both average order and trade sizes have steadily declined over the years. The slicing of orders allows for both a reduction in risk and footprint. Market participants have the necessary tools and expertise to represent orders in a multi-market environment. If an order size restriction is set for dark liquidity, despite the imbalances this would create, the size threshold should at a minimum contemplate current and expected future average order and trade sizes.

The proposed guidance is problematic with only *passive* (posted) orders in the dark being restricted to a minimum size. With the size requirement not being applied to *active* (smart-routed) order flow, the inherent information leakage resulting from a fill of an active order creates a model where passive orders cannot practically post in the dark. The primary purpose of a dark pool; to reduce market impact and footprint of larger orders; is severely compromised.

Given the lack of evidence to demonstrate that dark liquidity is damaging to market quality and integrity, the introduction of synthetic size requirements only serves to eliminate opportunities to trade and thereby increases opportunity costs.

**Question 2) Should Dark Orders be required to provide meaningful price improvement over the NBBO, and under what circumstances?**

***“Two Dark Orders meeting the same minimum size exemption should be able to execute at the NBBO. Meaningful price improvement should be required in all other circumstances, including all executions with orders not specifically marked in a manner indicating they are utilizing the minimum size exemption.” – CSA/IROC Recommendation***

We agree that when two large dark orders trade at or above a predefined threshold, price improvement need not be required. Dark orders of size should be permitted to trade at the NBBO.

Sourcing size liquidity remains a challenge in the Canadian marketplace. Dark pools enhance price discovery to the extent that they attract and aggregate non-displayed, latent liquidity that is not typically sent to a visible marketplace. Dark pools provide an electronic alternative to upstairs trading, providing more liquidity to the quote because the orders are immediately accessible to contra flow. As this liquidity is traded, the information content of the quote is further enhanced due to post-trade transparency.

Furthermore, we opine that meaningful price improvement need not be provided in all other circumstances. The benefit of trading in dark pools is not limited to price improvement. Other factors may include but are not limited to the ability to minimize market impact, sourcing additional available liquidity, and efficient and economical trade execution. A participant's choice to trade in a dark venue does not necessarily occur as a result of guaranteed price improvement. What is “meaningful” for improvement in an execution is not just trade price which we further address in question 4.

**Question 3) Should visible (lit) orders have priority over Dark Orders at the same price on the same marketplace?**

***“Visible orders on a marketplace should execute before Dark Orders at the same price on the same marketplace. However, an exception could be made where two Dark Orders meeting the minimum size threshold can be executed at that price.” – CSA/IROC Recommendation***

CIBC is in agreement that all visible orders should have allocation priority over dark orders at the same price, within a particular marketplace. Allocation priority should be based on price, then visibility (with visible orders first), then other factors, such as broker, time, volume, etc. based on marketplace rules. This allocation protects the incentive to post visibly and enhance price discovery.

**Question 4) What is a “meaningful” level of price improvement?**

***“Meaningful price improvement means that the price is improved over the NBBO by a minimum of one trading increment as defined in UMIR, except where the NBBO spread is already at the minimum tick. In this case, meaningful price improvement would be at the mid-point of the spread.” – CSA/IROC Recommendation***

This recommendation, in combination with recommendation 2, makes the assumption that smart-routed active orders (likely to be retail or algorithmic order flow) are only looking for price improvement, and

passive orders (likely to be institutional) are only looking for size execution. The motives of order placement are more complex than the "one size fits all" strategy implied by this logic.

Meaningful price improvement should not be limited to trade price only. Both underlying costs and rebate strategies factor into the economics of a trade. To date, price improvement has been a key differentiator for dark in Canada. As discussed in question 2, price improvement is only one feature which may make executing in a dark venue appealing. Liquidity posted in a dark venue may not be protected and can be by-passed by orders on transparent markets. To attract order flow dark pools must innovate; providing price improvement is a tool the dark pools currently employ. Providing rebates is a tool the lit markets currently employ. Both are ultimately of economic benefit to the participant, be it explicit improvement in the actual trade price or be it implicit price improvement calculated in the cost of trading.

The cost of seeking a better execution in a dark pool is accepting the possibility of not getting filled. The cost of seeking an immediate fill on a lit venue is foregoing potential price improvement in the dark. Consistent with our view on other guidance, without evidence of an existing problem, what constitutes 'meaningful' price improvement is a decision that will be made by a participant when choosing their execution venue.

Furthermore, 'meaningful' price improvement is dependent on the economics of a given trade; without a full understanding of the unique conditions prevailing for each transaction, it is incorrect to assume that a standard level of price improvement will have the desired economic impact. Regulating price improvement can therefore have the unintended consequences as marketplaces adapt their fee structures in order to compete and deliver the desired economics to participants; we are concerned that in a year or two, we may be further down the slippery slope discussing standardization of marketplace fees, to correct for new behaviours resulting from the introduction of minimum price improvement in dark markets.

## **In Conclusion**

Viewed collectively, the proposed guidance on dark liquidity significantly limits the dark model. Both allocation methodologies and price improvement decisions should remain in the hands of the marketplace. We are of the belief that competitive forces should be allowed to drive product differentiation and innovation. The unintended consequences of regulation should be further examined prior to the implementation of this guidance.

Thank you for the opportunity to provide our comments on Position Paper 23-405. Please feel free to contact us with any questions or requests for clarification.

Sincerely,



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