July 07, 2011

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- and -

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- and -

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Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department Of Justice, Nunavut
Ontario Securities Commission
Registrar of Securities, Prince Edward Island
Saskatchewan Financial Services Commission
Registrar of Securities, Government of Yukon Territory

RE: REQUEST FOR COMMENTS: PROPOSED NATIONAL INSTRUMENT 23-103, ELECTRONIC TRADING AND DIRECT ELECTRONIC ACCESS TO MARKETPLACES

Dear Sirs/Mesdames:

CIBC World Markets Inc. (“CIBC WM”) appreciates this opportunity to comment on the proposed electronic trading and direct electronic access rules. As a leading agency broker and Canada’s largest direct electronic access provider, CIBC WM is wholly supportive of a regulatory framework that facilitates electronic trading within acceptable limits and under appropriate supervisory oversight. We also believe that dispelling any perception that Canada permits “naked access” will be beneficial to our market’s global reputation – a reputation that has attracted significant new liquidity from around the world over the last three years.

We are strongly supportive of the establishment of common standards and practices that minimize systemic risk arising from the use of automated systems in our equity market and put all Canadian dealers on a common footing. We are pleased that the proposed rule builds upon current IIROC minimum standards for basic supervision of electronic order flow; the systems, policies, and procedures CIBC has put into practice have had to exceed existing IIROC standards and have been a key contributor to our success in managing the risks of this demanding business. We commend the principles-based approach taken in addressing the automated trading issue, and recognize that prescriptive rules are not the best approach to take in Canada - particularly given the broad range of activities the proposed rule is meant to cover.

In our comments below, we discuss certain details of the proposed rules from a principles-based perspective. Generally, we have found that certain detailed, prescriptive elements in the proposal tend to obfuscate the intentions of the rules. Particularly, the specific focus on pre-trade filters under the direct and exclusive control of Canadian dealers diverges from the rule's stated goals to enhance operational and credit risk management.

Such detailed and prescriptive elements have typically been handled at the SRO level (IIROC), as they require enforcement; rules at the Securities Act level have traditionally laid out principles for behaviour that can encompass the wide variety of marketplace participants in Canada. Although we are supportive of building upon the electronic supervision requirements put in place by IIROC, we believe that more benefits can be achieved through enforcement than through the absorption of SRO rules into the Securities Act, as this may lead to a litany of questions and new issues to be addressed – we have seen this happen recently as the SEC introduced rules around the regulation of a dealer's ability to manage risk in the United States, more appropriately a FINRA enforcement issue.

In our comments, we contemplate both the foreseen and unintended consequences of the proposed electronic trading and direct electronic access rules in the context of the following basic guiding principles, which we present for the Community's consideration:

(1) **Automated trading is a legitimate, valuable contributor to Canadian markets.** In addition to providing operational efficiencies to clients and dealers, automated trading has led to significantly tighter spreads and increased liquidity on the bid and the offer. The increased liquidity brought by specialized automated traders has also made it possible for new exchanges and ATSs to establish themselves, as it is easier for new markets to attract net new participants than it is to dislodge existing ones from competing venues.

(2) **Automated trading requires automated and manual supervision.** Automated supervision includes the order and credit checks discussed in the proposed rule. More importantly, however, automated supervision must include the people and procedures that can react to the information produced by the automated supervision system. Forcing all decisions to be made on a "pre-trade" basis is not always appropriate, and may in fact increase risk in the long run.

(3) **A simple re-distribution of risk management tools does not reduce the total risk being managed, as we learned during the credit crisis.** The presence and quality of risk filters is far more relevant to the management of systemic risk than where the filters reside.

(4) **Automated trading is inclusive of all order flow.** In addition to high frequency DEA clients, potential systemic risks can also be created by technical disruptions from various marketplace participants including: "low-frequency" DEA clients, proprietary desks at a dealer, affiliated entities of a dealer, and marketplaces. These participants all rely on automated systems that could potentially disrupt fair and orderly markets if not properly tested or supervised. We are supportive of the rule applying to all of these constituents, and note that the overwhelming majority of technical disruptions to the market have come from marketplaces.

(5) **Risk should be managed by whoever is in the best position to manage it**. The only way to effectively reduce risk is to ensure that its management is entrusted to the most appropriate party, based on technical capabilities, access and proximity to client information, and level of commitment. Generally, the party with the most to lose is the most effective manager of risk, because their incentives are properly aligned.

(6) **Order Creation does <u>not</u> equate to Trade Creation:** This should be self-explanatory but we point it out because true ***credit exposure is generated post-trade***, not post-order-entry, through changing net positions. This is when a transfer of beneficial ownership occurs and, as a result, settlement liability is created.

Under these guiding principles, we conclude that aspects of the proposed rule - while well intentioned and necessary - go too far in some respects and not far enough in others, resulting in misalignment with regard to the mitigation of credit and technology risk. We agree that automated orders should be subjected to automated filters, including order-by-order "fat fingers" checks, credit checks, and pattern-based compliance checks.

However, we do not believe that it is necessary to interpose broker order-by-order filters in cases where a qualified DEA client has demonstrated that these filters already exist in their system, and that client is a regulated broker dealer in the United States or Canada and is subject to ongoing capital adequacy requirements. We believe it is appropriate for such filters to reside with the DEA client, particularly in cases where that client is an SEC-registered broker whose system complies with similar requirements in the United States.

We find that "credit" filters, as proposed, will not do enough to reduce risk to the client, their broker, or the market. Limits imposed on a per-order or per-trade basis, or pre-set limits set for a client at each marketplace, are buying power limits, not credit limits. They are a basic level of "fat finger" protection, particularly if applied on a per-order basis. The proposed rule diminishes the value of credit filters by substituting buying power limits in order to call them "pre-trade"; real credit filters must be applied on a by-client or by-account basis, and take a holistic view of the portfolio across markets. When these limits are surpassed, trading should be interrupted, akin to a "credit circuit breaker"; credit calculation updates are, by necessity, performed post-trade.

The proposed rule also focuses on the executing broker as the key risk manager in the transaction chain. Risk is created by the client/order generator, and is borne by the clearing broker. They are the key links in the chain towards which risk management efforts should be targeted. Clearing brokers should also be required to have risk checks in place, and omnibus clearing brokers should similarly be required to maintain policies, procedures, and controls that apply to introducing broker clients who clear through them. The credit exposure of these introducing broker clients should be subjected to limits as well. This is a more effective way to reduce systemic credit risk in the market.

Finally, we find that the proposal should consider marketplaces as key sources of risk. As system hubs, they are integral to the testing and operation of automated trading systems, and yet have failed in many respects to reduce risk in the system and are the most significant potential single points of failure. We believe this is because their incentives are not properly aligned due to their protected status under the Order Protection Rules, and their contractual limitation of liability.

We are pleased to provide our general comments on the proposed rule, followed by specific questions and recommendations.

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<u>GENERAL COMMENTS</u>

The proposed rule aligns with recommendations we have seen in the United States (SEC rule 15c3-5, Risk Management Controls for Brokers or Dealers with Market Access) and globally (IOSCO Final Report on Direct Electronic Access to Markets). However, we must consider whether the risks in Canada similar enough to those in other jurisdictions to justify mimicking foreign rules. Canada's regulatory system is advanced in comparison to many other jurisdictions, with a tradition of real-time monitoring by regulators and entrenched transparency and fairness rules that lend themselves perfectly to the development of automated trading. The principles of the proposed rule are globally aligned, but some of its prescriptive elements fall short of addressing systemic risks and may create a disincentive for global automated traders to engage with the Canadian capital markets.

Applicability

We commend that the proposed rule has not been limited to the provision of DEA to clients of dealers, but also includes trading by the dealer and its affiliates. The rule is correctly, broadly, defined as applying to all order flow that enters the markets electronically. It acknowledges that automated trading is performed by Canadian brokers today – a fact that has often been overlooked as attention has been focused on DEA clients. The application of the rule to all participants will help ensure minimum standards are met by dealers in their operations, and we hope that it will be rigorously and fairly enforced.

The proposed rule also recognizes DEA clients, including HFTs, as having a legitimate role in the marketplace, and focuses on how these critical participants can be incorporated into our marketplace safely.

Existing Rules

We note that the comment that "DEA…orders do not pass through a dealer's systems and no controls are in place"; and that "currently there are no rules that apply specifically to electronic trading"[1]; are misleading statements from the perspective of our business and the Canadian marketplace. Existing IIROC guidance clearly demands that all automated order flow[2] be exposed to risk filters and compliance systems, and that a dealer be

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[1] Proposed National Instrument 23-103, p 4133.

[2] IIROC Notice 09-0081, "Specific Questions Related to Supervision of Algorithmic Trading", March 20, 2009:

"IIROC expects that a Participant will, at a minimum, ensure that each algorithmic trading system has:

- *been tested under various market conditions to identify problematic outcomes related to the operation of the algorithmic trading system;*

able to interrupt DEA client order flow. This has always been the difference between providing sponsored access, which is permitted, and naked access which is not.

At CIBC WM, under the guidance of these rules, we have pioneered due diligence procedures to ensure DEA client order flow is properly supervised and filtered, and that automated filters are tested and functional. We have worked with our DEA clients to ensure CIBC WM has the ability to independently interrupt flow and cancel orders, and have introduced real-time systems to manage credit and leverage for a client set that routinely accesses multiple marketplaces directly.

The goals of the proposed rule by could be more easily achieved through the establishment of principle-based rules by the CSA, and the enforcement of these principles and existing rules by IIROC, without the risk of putting up barriers to entry and free competition.

Risk

Given the existing IIROC treatment, the proposed rule does not significantly improve risk mitigation for dealers or the market at large. Instead, the rule redistributes risk mitigation, with potential downside consequences for affected clients and dealers.

Under the principle that risk should be managed by whoever is in the best position to manage it, the proposed rule's focus on the executing broker as a singular risk control point is misaligned, since the executing broker neither creates nor bears responsibility for the financial risk resulting from the transaction. We point out that effective management of systemic risk will recognize that:

a) **On order creation, the contingent risk resides with the client or dealer** generating the order. The client/dealer has a view into their entire portfolio – which may span asset classes and jurisdictions, and understands their own specific risk tolerances, systems, and most importantly motivations for placing the order. This means that the order originator's is incented and able to manage total portfolio risk and its own contribution to total systemic risk.

b) **On order placement, the operating risk resides with the marketplace.** As central connectivity hubs in a vast marketplace network, marketplaces (particularly those that are protected under OPR) introduce systemic operating risk, from technology malfunctions, rules, and updates/changes that are imposed on the entire Community. Marketplaces are positioned to manage systemic operational risk.

c) **On trade consummation, the credit risk resides with the clearing dealer** who settles the client/dealer's trades and is ultimately responsible for the transaction. A prime dealer can refuse to settle, and an executing dealer never takes on counterparty risk. With capital at risk and a view into the order originator's leverage, the clearing dealer is incented and able to manage counterparty credit risk.

Given the distribution of risk, the proposed rule could improve counterparty risk by focusing less on the role of the executing broker. It places too much emphasis on order-level, pre-trade controls. Our concern is that, detrimentally, a false sense of security could be created in the Community by the interposition of order-by-order checks in an automated environment - these filters only address the least likely way that problems with automated systems can occur. Putting faith in pre-order checks, rather than true intraday credit calculations, may actually

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- *built-in features or functionality that prevent (or provide a real-time alerts when) certain pre-programmed order or trade parameters from being exceeded (i.e. certain volume, order or price limits); and*
- *an "override" functionality which either automatically "disengages" the operation of the algorithmic trading system or permits the Participant to do so remotely.*

TSX Trading Rules, Policy 2-502 "Conditions for Connections"

(1) For the purposes of Rule 2-502, the system of the Participating Organization is required to:

(c) comply with specific requirements prescribed pursuant to Rule 2-502, including a facility to receive an immediate report of, or to view on a real-time basis, of the entry or execution of orders;

(d) enable the Participating Organization to employ order parameters or filters (which parameters can be customized for each eligible customer on the system) that will reject order over a certain size or value, or route these orders to the Participating Organization's trading desk;

(2) For the purposes of Rule 2-502, the agreement between the Participating Organization and the customer shall provide that:

(d) the Participating Organization has the right to reject an order for any reason;

(f) the Participating Organization has the right to change or remove an order in the Book and has the right to cancel any trade made by the eligible customer for any reason;

elevate systemic counterparty risk as clients believe these simple checks provide adequate protection and are incented to take greater risk themselves.

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A) CLIENTS ARE IN THE BEST POSITION TO MANAGE RISK PRE-ORDER ENTRY

Impact on DEA Clients

The proposed rule does not provide significant additional protection for dealers, clients, or the marketplace at large relative to the existing UMIR rules. Its largest impact will be on participants that already comply with UMIR, creating negative incentives that lead automated DEA clients to choose between registering as broker dealers or accepting additional filters on their flow and the additional latency that this implies. Because either choice has a direct pecuniary impact, the rule will erect a barrier to entry to the Canadian marketplace for some DEA clients, or an incentive for current DEA clients to leave Canada altogether.

Is the marketplace better off with such barriers? If DEA clients are slowed down by duplicative filters, they will take on additional risk in their operations; visible spreads may widen and size on the bid and offer may decline as a consequence. If DEA clients register as brokers, they would be under direct IIROC oversight but would only be held to the regulators' minimum standards; dealer credit standards would be eliminated from the risk control chain and they would no longer be backed by the capital of large financial institutions, increasing the damage that could be done to the Street in the event of a systemic failure.

Identification of DEA Clients

CIBC WM has no objections in principle to uniquely and transparently identifying DEA clients – we do this today. However, recently a marketplace has systematically prevented certain DEA client (as well as institutional) order flow from taking liquidity on its facility. Given this precedent – the first CSA-approved circumvention of fair access rules - we are concerned about the requirement to provide lists of DEA client identifiers and names to exchanges as required in the proposed rule[3]. We are concerned that marketplaces will exclude, slow down, or otherwise discriminate against DEA orders using rules and order types, to appease specific constituencies following the recent precedent. Any requirement to submit DEA client data to marketplaces must be accompanied by a requirement for marketplaces to keep this information strictly confidential and restricted, and to keep it from being used to segregate and discriminate against DEA client order flow.

In addition, although we agree that identifiers and client names should be transparently provided to IIROC for monitoring purposes, but do not support the provision of DEA client names to exchanges. We are concerned about leakage of client information from marketplaces, since central lists of DEA clients make tempting prospect lists for competitors. We believe that the requirement to divulge client particulars should be limited to regulators only, and that DEA identifier lists should be anonymously provided to exchanges – that is, identifiers should be provided but on a "no names" basis.

Allocation of Risk Management

The proposal permits the allocation of risk management to another investment dealer, who is "in a better position to manage risks due to proximity and knowledge of its clients".

We do not believe that the proposed rule goes far enough in permitting allocation of risk management. In limiting allocation to investment dealers, the rule does not always permit risk to be managed by those who are in the best position to manage it. Instead, the rule should recognize that any two regulated broker/dealers - whether they are regulated by the SEC or IIROC - should be permitted to allocate risk management tools between one another. This is in keeping with the principle established in the SEC's recent rule proposals[4] on electronic access.

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[3] "*Proposed National Instrument 23-103, Electronic Trading and Direct Access to Marketplaces",* Section 10.2(b), p 4156

[4] "Risk Management Controls for Brokers or Dealers with Market Access", Securities and Exchange Commission, 17 CFR Part 240, p.58

> *After careful consideration of the comments submitted with respect to the possible allocation of certain compliance responsibilities to broker-dealer customers, the Commission has determined to permit, subject to certain conditions, broker-dealers providing market access to reasonably allocate control over certain regulatory risk management controls and supervisory procedures to customers that are registered broker-dealers who, based on their position and relationship with an ultimate customer, can more effectively implement them.*
>
> *Specifically, the Commission is modifying Proposed Rule 15c3-5(d) to permit a broker-dealer providing market access to reasonably allocate, by written contract, control over specific regulatory risk management controls and supervisory procedures to a customer that is a registered broker-dealer, so long as the broker-dealer providing market access has a reasonable basis for determining that such customer, based on its position in the transaction and relationship with an ultimate customer, has better access to that ultimate customer and its trading information such that it can more effectively implement the specified controls and procedures.*

B) MARKETPLACES ARE IN THE BEST POSITION TO MANAGE OPERATIONAL RISK

The Role of Marketplaces

The intended benefits of the proposed rule cannot be achieved without addressing the role of marketplaces in systemic risk management.

Certain behaviours by marketplaces – including not providing basic, automated protections and risk mitigants and amplification of systemic technology risk can be explained; they have nothing at risk. Marketplace contracts continue to carry liability provisions from the monopoly days – that is, minimal to no liability is taken on by the marketplace in contractual agreements with Participating Organizations. We note that this is no longer appropriate, particularly since the Order Protection Rules force participants to connect to these marketplaces and the proposed rule forces all participants to "comply with all applicable marketplace … requirements that must be satisfied on a pre-trade basis"[5], further bolstering their protected status.

The combination of rules compelling dealers to connect to protected marketplaces and zero liability creates a moral hazard – marketplaces have the right to force unlimited technological experimentation and systemic risk upon participants, to avoid work and cost or to create problems and sell participants the tools to solve them. Nothing is more dangerous than a marketplace that has no incentive to control the systemic risk it is introducing into the market. In keeping with the principle that risk should be managed by whoever is in the best position to manage it, we strongly recommend that marketplaces be put in a position to manage the risk they create. They must be required to take on liability for their actions and align their interests in favour of risk reduction.

As an example, we believe that marketplaces should be required to provide cancel-on-disconnect functionality, where the order entry session is closed and all orders in the marketplace book are automatically removed the moment a disconnect in the order entry session is detected. This is the most basic, first line of defense in the risk management of automated systems. It is a standard marketplace offering in the United States, and many US DEA clients build their systems with the assumption that when their filters are triggered, they can disconnect and the marketplace will kill their orders and eliminate any exposure. Cancel on disconnect offers critical protection in cases where the participant's system loses connectivity, and the participant cannot immediately act to reduce their exposure. CIBC WM has provided additional examples in our comments on proposed amendments to National Instrument 21-101, dated June 20, 2011 which has been included as an appendix to this document.

C) THE CLEARING BROKER IS IN THE BEST POSITION TO MANAGE CREDIT RISK

The proposed rule's focus on the executing broker overlooks the best available opportunity to reduce systemic credit risk. The clearing broker, ultimately responsible for the trade, is properly incented and positioned to manage credit risk created by the client. Even a prime broker, for example, can exercise their "right to disaffirm" a client's trade leaving the clearing broker liable. We believe that the provision of direct electronic access should be contingent on the presence of a sound clearing broker with appropriate balance sheet to cover all of their clients' activities – covering its introducing brokers as well as the introducing brokers' DEA clients. Otherwise direct electronic access should require self-clearing arrangements backed by appropriate assets.

In order to reduce systemic risk, omnibus clearing brokers should not be permitted to exceed the capital of their firm when allowing their introducing broker clients to clear through them for DEA activity, and clearing brokers should be required to have automated credit checks in place, which monitor the net positions of clients intraday. The pre-order entry buying power limits introduced in the proposed rule may be appropriate for executing brokers, but will not limit the risk of a clearing broker. Regulators should ensure that DEA trades undertaken are properly backed; this is the most effective way to remove significant systemic risk from Canadian equity markets.

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Risk of Regulatory Arbitrage

There has long been a regulatory imbalance favouring American over domestic markets, and we have seen better liquidity conditions in the United States, where spreads have been tighter. Trading in Canadian symbols has migrated to the USA, and it has only been recently that this outbound migration has reversed itself. DEA has allowed Canada to import massive amounts of liquidity, initially from the USA, but now from other jurisdictions as well. Canada has an advantage with its real-time monitoring regime and stable, transparent market. Imposing unreasonable barriers to entry for DEA reduces the benefits of this favourable regulatory and structural imbalance; there are other markets in which these participants can engage without having to invest in becoming a Canadian broker.

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[5] Ibid. Section 3.3 (b) I, p 4153

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SPECIFIC QUESTIONS

Questions Relating to Definitions

1. ***We request an expanded definition of eligible registrants:***
   6. (2)> A participant dealer may not provide direct electronic access to a registrant, unless the registrant is:
   A participant dealer; or
   A portfolio manager

   If a participant dealer is a marketplace participant that is an investment dealer; what is the definition of a marketplace participant?

2. ***Our position is that SEC-registered dealers should be included in the definition of investment dealers; does the CSA agree with this?***

Questions Relating to Limitation of DEA Access

3. ***Does the proposed rule replace, or complement Policy 2-501 "Designation of Eligible Clients"? If so, will all current categories of eligible client be maintained?***

4. ***We do not believe that DEA access should be limited to institutional investors and a limited number of other persons; assets do not guarantee sophistication. We propose that the provision of DEA should be determined by the dealer, and that sophisticated retail accounts should be permitted DEA under the dealer's discretion – particularly where that dealer is the clearing broker. Does the CSA agree with this?***

Questions Relating to the Allocation of DEA Risk Monitoring Responsibilities

What does it mean that a third party providing risk controls has to be "independent" of the DEA client as used below? Does it refer only to control over filter parameters? Does it refer to physical location? Or ownership?
<3. (5)> A third party that provides risk management and supervisory controls…must be independent from each DEA client of that marketplace participant

5. ***Is it sufficient to have a DEA client's technology under the control of a third party? If a third party vendor is providing controls over automated flow, must these be under the direct and exclusive control of the participant? That is, does potential control or access of an independent third party invalidate the controls for the purposes of this rule?***

6. ***Does the proposed rule permit allocation of certain elements of control to a third-party that is an affiliate of the dealer? Is a US broker-dealer considered to be an appropriate third party?***

7. ***By strict definition, institutional buyside firms delivering orders through automated systems could be included as subscribers to Liquidnet; would they be subject to the implementation of controls and procedures? Would Liquidnet be responsible for credit monitoring of such subscribers?***

Capital & Credit Definitions

8. ***We request a definition of credit and capital as they are used below:***
   <3. (3)(a)(i)> controls must systematically limit financial exposure of the marketplace participant
   Preventing the entry of one or more orders that would result in exceeding appropriate pre-determined credit or capital thresholds for the marketplace participant and, if applicable, its DEA client

9. ***What is the expectation on strategy-based capital adequacy?***

10. ***Is a per-order check the minimum standard requested in the excerpt below?***

In order to address the financial exposure that might result from rapid order entry, a participant dealer should also consider measuring compliance with set credit or capital thresholds on the basis of orders entered rather than executions obtained.

Miscellaneous

11. ***We request that the CSA provide clarity on jitney arrangements, and whether risk controls can be allocated in cases where one broker jitneys through another.***

12. ***Does the proposed rule apply specifically to equities, or to all asset classes?***

13. ***The requirement, excerpted below, to comply with ALL marketplace requirements that must be satisfied on a pre-order entry basis causes us major concern. What safety checks will be in place to ensure pre-order entry requirements imposed by marketplaces will be reasonable?***
    <3. (3)(b)(i)> preventing the entry of orders that do not comply with all the applicable marketplace and regulatory requirements that must be satisfied on a pre-order entry basis

14. ***Can the CSA discuss its view of the impacts of DEA clients registering as broker dealers - as a result of the proposed rule - will be on credit risk to the clearing ring?***

15. ***We note that smart order routers generate (child) orders in an automated fashion. Are dealer or marketplace smart routers included under the definition of an automated order system[6]?***

CONCLUSION

Given the recent experience in the United States, we encourage regulators to leave a large implementation window for the Electronic Trading Rules. The prescriptive elements in these rules will require the CSA to address very specific situations, and we expect that the implementation timeline will be at least as long.

Electronic trading provides valuable and important liquidity to Canadian equities markets. We believe Canadian market participants and regulators appreciate that a significant majority of liquidity, constituting passive orders and quotations, comes to Canadian marketplaces from the United States through direct electronic access relationships. In their commendable efforts to manage systemic risk, regulators should cautiously consider the potential unintended consequences of prescriptive elements in the proposed rule that could disrupt the significant progress Canadian markets have made in expanding access to global liquidity pools.

We believe that negative consequences for Canada can be circumvented by directing appropriate attention to the key elements in the risk chain that have not been sufficiently addressed in the proposed rule – order originators and clients, marketplaces, and clearing brokers. Automated trading would then be supervised in an automated way, the difference between order entry and trade consummation would be properly recognized, and the solution would impose net new controls rather than simply reallocating existing controls to different stakeholders.

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Thank you for providing the proposed rule for comment. We agree it is an important step in establishing equitable and efficient rules for all Canadian securities marketplaces. Please feel free to contact us with any questions or requests for clarification.

Yours truly,

"Thomas Kalafatis"

Thomas Kalafatis
Managing Director
Head, Prime Services Group
CIBC World Markets Inc.

"James Beattie"

James Beattie
Managing Director
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[6] Part 1, Definitions

APPENDIX 1

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June 20, 2011

Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Government Services of Newfoundland and Labrador
Superintendent of Securities, Department of Justice Government of Northwest Territories
Nova Scotia Securities Commission
Superintendent of Securities, Nunavut
Ontario Securities Commission
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Re: PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 21-101 *MARKETPLACE OPERATION* AND NATIONAL INSTRUMENT 23-101 *TRADING RULES*

Dear Sirs / Mesdames:

CIBC World Markets Inc. ("CIBC WM") appreciates this opportunity to comment on the above noted proposed amendments. As illustrated in the proposal, the key objective is to update and streamline the regulatory and reporting requirements for all marketplaces. We would like to take this opportunity to express our frustration with the lack of coordination regarding marketplace initiatives, both technical and business driven. Further to this, we would like to re-state our views on the introduction of minimum size requirements for dark liquidity as well as provide comment on the definition of a marketplace.

Comments on the Proposed Amendments

Marketplace Operation - Notice Periods

APPENDIX 1

There is both significant cost and insufficient time to integrate marketplace changes into existing technologies within the required regulatory / exchange posted deadlines.

Under current guidelines, marketplaces are mandated to provide all technology requirements regarding interfacing with or accessing the marketplace at least 90 days prior to operations for a new marketplace; or 60 days prior for an existing marketplace (Section 12.3 of NI 21-101).

In particular for a new marketplace, these requirements can be distributed prior to regulatory approval. This is wholly inappropriate given that these changes must be integrated into existing business planning; without assurance that the marketplace will receive the requisite approvals. The clock for access to a new marketplace should begin only once approval has been granted otherwise this breaks the intended spirit of the guidelines around marketplace operation.

As a real world example, TMX Select announces their plans to launch an ATS on March 4, 2011. The anticipated start date is June 20, 2011; which is in accordance with the mandated 90 day notice period. However, there is no assurance that the proposed marketplace will receive regulatory approval and therefore it is unrealistic for participants to sideline other business priorities in order to meet an unconfirmed date. In the case of TMX Select, regulatory approval is granted only on June 3, 2011 and the launch date is pushed to July 11, 2011. The true notice period is therefore 25 days.

We believe that, in order to allow participants to meet their current obligations, all marketplaces must provide suitable notice on proposed operational changes. We are in agreement that the current regulatory guidance of 60 days for an existing marketplace, or 90 days for a new marketplace is sufficient. However, this notice period should not apply until the necessary regulatory approvals are in place and communicated out to the public at large.

We recommend that this issue be addressed within the proposed amendments to marketplace operations.

Marketplace Operation – Testing Facilities

Protected Canadian marketplaces introduce significant technical complexity, and are not held to account. Major system changes, such as the splitting of data feeds or the changing of messaging formats, introduce new technical risk into the market. The frequency of these changes is accelerating, increasing the risk that a participant may not keep up – proper regression testing of systems is time consuming. We believe that, in exchange for their protected status, marketplaces should be required to batch their updates, upgrades, bug fixes, and new functionality into regularly scheduled drops. These should include all updates from all marketplaces, making the process of change more predictable and manageable and minimizing the amount of system-wide regression testing required for compliance with the proposed and current rules.

Order Protection Rules force participants to connect to protected marketplaces. This places an expectation on dealers and their clients to ensure their systems are tested in accordance with prudent business practices. Fulsome test environments are needed in order to comply, otherwise performance cannot be tested.

The lack of a non-functional performance testing environment at any marketplace makes it impossible to know the effects of order rates on latency and on the throughput capacity of the marketplace. Because these critical tests cannot be performed, it is not possible for participants to test in accordance with prudent practices.

We believe that, in order to allow participants to meet their current and proposed obligations, all protected marketplaces must provide full-scale test environments that permit performance and functional testing, or else risk losing their protected status. Proposed rules force a great deal of cost on broker dealers and their clients, and the excuse that full-scale test environments are expensive no longer holds.

Minimum Size Requirements for fully hidden orders

The proposed amendments introduce a requirement that orders meet a minimum size in order to be exempt from transparency requirements; though at this time an appropriate minimum size is not defined.

Further to our previous comments on dark liquidity, 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.

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.

Marketplace Definition

In the companion policy of NI 21-101, clarification is given that a "*dealer using a system that brings together multiple buyers and sellers using established, non-discretionary methods to match or pair order 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*".

The marketplace definition distinguishes between functions being performed systematically, using electronic methods, and those which are performed manually in the "upstairs" market. In this clarification, only the electronic matching of orders applies to the definition of a marketplace. As the evolution of markets has shown, dealer workflow continues to become more automated. We urge regulators to consider unintended consequences as this guidance could lead to a requirement for all dealers to become marketplaces.

Furthermore, we question the approval of the Alpha Intraspread facility as contradictory to the spirit of this guidance. We re-iterate our view that fair access rules should ensure regulation is focused on broad accessibility to marketplaces and the liquidity that resides in them.

Our interpretation of the proposed language in the companion policy is that participants who create internalization pools or engines will be regulated as marketplaces and as such, subject to fair access rules. However, with the introduction of the Alpha Intraspread facility, precedent has been set for the selective access of order flow, thereby permitting dealers to control trading partners through exclusionary trading practices. Given this precedent, we are concerned that marketplaces can exclude, or otherwise discriminate against counterparties using rules and order types, to circumvent fair access.

In Conclusion

APPENDIX 1

The introduction of new marketplaces; and changes to existing marketplace operations force a great deal of cost on broker dealers and their clients. Proposed rules give marketplaces the right to force technological change and risk on participants. We propose that this issue be addressed within NI 21-101 such that marketplace changes are adequately controlled to allow participants the requisite time to adapt to these mandatory changes.

Thank you for the opportunity to provide our comments on the proposed amendments to National Instrument 21-101. Please feel free to contact us with any questions or requests for clarification.