



CIBC World Markets Inc.
Brookfield Place
161 Bay Street, 5th Floor
Toronto ON M5J 2S8
Tel: 416 594-8149

Jun 1, 2019

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

and

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, QC, H4Z 1G3
consultation-en-cours@lautorite.qc.ca

and

Kevin McCoy
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
Toronto, Ontario M5H 3T9
kmccoy@iiroc.ca

RE: Joint CSA/IIROC Consultation Paper 23-406
Internalization within the Canadian Equity Market

CIBC Capital Markets (CIBCCM) thanks you for this opportunity to comment on Consultation Paper 23-406 *Internalization within the Canadian Equity Market* ("Consultation Paper").

CIBCCM is the investment banking platform of Canadian Imperial Bank of Commerce (CIBC). We are a registered Canadian broker-dealer, engaged in, among other things, providing equities trading and execution services to retail and institutional investors. Our comments reflect the views of an institutional broker dealer and a retail broker dealer who is an active participant in Canadian equity markets.

We compete globally for capital and it is in the best interest of all Canadian participants to deliver high quality capital markets driven by the price discovery process, which concentrates

liquidity to the benefit of investors - particularly in a market the size of Canada which has the potential to be impacted by liquidity challenges. In our opinion, a healthy market will include a diversity of investment objectives, a variety of types of order flow, and limited client segmentation.

As we interpret it, the general objective of this consultation is to review whether the existing rules ensure that the Canadian equity markets continue to bring together all types of participants in a transparent and efficient manner, benefiting the collective good. Or, whether the practices broadly characterized as internalization activities, are harming or have the potential to harm the integrity of the Canadian equity markets, although in singularity these practices may provide benefit both to the end investor and the unique participant undertaking these activities - the individual good.

We commend the regulators for their balanced portrayal of the issues in this consultation paper, and for seeking industry guidance prior to the development of policy change meant to address any perceived issues.

Our general position

We support the promotion of balance as it applies to internalization practices. Central to the consultation objective is the alignment of the collective good to the individual good, to the extent practicable. Further to this, in our opinion it is the interests of the market as a whole that ought to take precedence should there be a conflict between the two. From this lens, we submit the following - Canada has, over the evolution of our markets, developed a unique market structure that has served us well and has been to the benefit of Canadian equity markets. Specifically, we believe broker preferencing has been net beneficial to the fabric of Canadian market structure.

Because on-book internalization takes place at the marketplace via broker preferencing, the desire to internalize through dark pools or single-dealer platforms does not currently exist as it does in the US and elsewhere. This has allowed us to escape some of the market structure challenges we have seen in other markets such as the proliferation of dark pools and bilateral arrangements with wholesalers, both of which have the potential to compromise transparency and the price discovery process, as well as being rife with conflicts of interest. In our opinion, by its inclusion in marketplace matching allocations, broker preferencing continues to incent dealers to commit orders to the order book and has been a deterrent to greater fragmentation.

Broker preferencing exists as a consequence of order exposure rules, which to encourage transparency and price discovery, requires that small orders be immediately exposed to the market. Brokers are encouraged to internalize in the central limit order book, therefore the competitively priced orders placed can be accessed by other market participants. This allows brokers to maintain the advantage of their flow and at the same time provide liquidity and information to the market. This matching allocation methodology is a valid approach to marketplace mechanics, and serves the purpose of balancing the collective good for the market with the individual good for the unique participant and client.

Per the data provided in the consultation paper, there has not been a significant increase to broker preferencing rates, and these rates remain largely in range to historic levels, though we acknowledge that this review may be a pre-emptive measure should these rates continue to increase.

What has changed over the more recent evolution of Canada's market structure is an increase of segmentation practices at the marketplace level. Fair access has been compromised through greater and greater client segmentation. The ability to segment order flow and therefore more accurately select the counterparty one trades against has led to potentially abusive practices which leverage broker preferencing in a manner in which it was not originally intended for.

Because of the potential for participants to abuse the system, we are considering the removal of this practice. However, this has been a long standing and legitimate practice in Canada. In our opinion, the more appropriate action may be regulatory enforcement should there exist abusive practices that run contrary to the spirit of the existing rules.

Responses to Questions for Market Participants

1. How do you define internalization?

We define internalization as orders matching within a single dealer, that participants have no ability to reasonably interact with. We do not believe that broker preferencing eliminates the ability for this interaction. As it pertains to marketplace matching, it simply means that a broker benefits first from their own resting orders, provided they already have orders in the order book as opposed to providing liquidity post knowledge of the contra order. The incentive to encourage dealers to commit orders to the order book remains.

2. Are all of these attributes relevant considerations from a regulatory policy perspective? If not, please identify those which are not relevant, and why.

We are in agreement with the defined key attributes of a market which are provided in the consultation paper.

3. How does internalization relate to each of these attributes? If other attributes should be considered in the context of internalization, please identify these attributes and provide rationale.

We believe that internalization - where orders are not exposed to the market, or where orders may be so briefly exposed to the market that there is no ability to reasonably interact with these orders - will have a negative impact on many key market attributes, in particular liquidity available in the market, price discovery, and dissemination of information (transparency). Although there may be a benefit to specific attributes such as immediacy of a fill, on the whole, should levels of internalization in Canada grow, our market will be adversely impacted.

4. Please provide your thoughts on the question of the common versus the individual good in the context of internalization and best execution.

A short term view on profitability benefiting the individual good may have a longer term consequence of harming Canadian markets whereby investors choose to invest in regions other than Canada, ultimately harming both the individual and collective good.

A market that balances these two objectives is the optimal structure, and in order to achieve this, there ought to be limited segmentation of order flow - where access to liquidity is broadly achievable by all.

- 5. Please provide any data regarding market quality measures that have been impacted by internalization. Please include if there are quantifiable differences between liquid and illiquid equities.*

N/A

- 6. Market participants: please provide any data that illustrates the impacts to you or your clients resulting from your own efforts (or those of dealers that execute your orders) to internalize client orders (e.g. cost savings, improved execution quality) or the impacts to you or your clients resulting from internalization by other market participants (e.g. inferior execution quality/reduced fill rates).*

N/A

- 7. Please provide your views on the benefits and/or drawbacks of broker preferencing?*

We do not believe that broker preferencing detracts from the common good. To the contrary, we believe this practice to be net beneficial to our markets in the form of a compromise between what is good for the overall market and what is good for the individual participant.

Restrictions on broker preferencing will make dealers less efficient and increase costs for the industry and for clients, making Canada a more expensive place to trade.

We believe that the alternative to a broker preferencing regime is a worse outcome for investors. It will create an economic incentive for a broker to set up their own trading venues to better trade against their contra order flow, to minimize costs and to increase efficiencies for the individual dealer. By way of example of unintended consequences, see the European market and adjustments post the implementation of MiFID II which sought to increase order flow to lit marketplaces. We now see a proliferation of Systematic Internalizers - causing even greater market complexity and increased fragmentation. Similarly, in US markets where internalization is an acceptable practice, we see greater fragmentation of venues and segmentation of order flow - which from our lens is not the best path forward for Canada given the size and scale of our equity markets.

- 8. Market participants: where available, please provide any data that illustrates the impact of broker preferencing on order execution for you or your clients (either positive or negative).*

From our observations, and based on CIBC statistics, there is no singular client segment that benefits disproportionately from broker preferencing. Like for like, all our client segments benefit similarly.

9. *Please provide your thoughts regarding the view that broker preferencing conveys greater benefits to larger dealers.*

The perception is that broker preferencing provides an out-sized benefit to larger dealers. We oppose that view as it can be beneficial to all dealers provided that they have two-sided order flow.

No doubt there is benefit to full-service dealers, where retail channels may be part of the make-up of their order flow, and may lead to greater opportunities for matching given the diverse nature of their order flow. In addition, the larger the dealer, and the more diverse their order flow, the greater their trading share in the market - which may include a greater proportion of broker-to-broker trades, which may or may not be a result of broker preferencing.

10. *Does broker preferencing impact (either positively or negatively) illiquid or thinly-traded equities differently than liquid equities?*

Broker preferencing is more frequent in the trading of liquid securities, but more pronounced in the trading of illiquid securities where queue jumping resulting from a broker preferred trade may have a greater impact on the perception of 'fairness'.

11. *Do you believe that a dealer that internalizes orders on an automated and systematic basis should be captured under the definition of a marketplace in the Marketplace Rules? Why, or why not?*

Yes - if the technology within a dealer has moved beyond the scope of an order router and is acting as a marketplace then it should be regulated as such, and be held to the appropriate fair access standards.

12. *Do you believe segmentation of orders is a concern? Why, or why not? Do your views differ between order segmentation that is achieved by a dealer internalizing its own orders and order segmentation that is facilitated by marketplaces?*

Over the past few years, our markets have seen the addition of exchange mechanisms that facilitate the direct segmentation of client flows. This includes speed bumps, new matching allocation methodologies, more explicit identification of counterparty by trading ID and new pricing models. Without this ability to more directly segment client flows and for counterparties to be more selective about who they may be trading against, the increase in internalization activities may not be perceived an issue.

Greater segmentation, be that through internalization mechanisms or otherwise, has the potential to make Canadian markets considerably less attractive to investors as it leads to dealer workflows or internalization activities that effectively removes retail order flow from the broader market.

Finally, we believe that segmentation at the broker level should be compliant with UMIR 8.1 - and be required to obtain price improvement in these circumstances. Similarly, where a dealer is leveraging segmentation at the market level, they ought to be held to the same standard.

13. Do you believe that Canadian market structure and the existing rule framework provides for optimal execution outcomes for retail orders? Why or why not?

We look to other (global) markets for a frame of reference and believe that Canada's model is an excellent model for maximizing price discovery to the benefit of all investors and trading firms.

In respect of broker preferencing, retail benefits as it eliminates the direct need to be the fastest to market to manage queue position.

14. Should the CSA and IIROC consider changes to the rule framework to address considerations related to orders from retail investors? If yes, please provide your views on the specific considerations that could be addressed and proposed solutions.

We believe that order routing disclosures, inclusive of retail and institutional channels should be a policy priority. Transparency around broker executions and execution quality statistics would go a long way to informing clients about the manner in which brokers handle orders.

15. Are there other relevant areas that should be considered in the scope of our review?

As it pertains to internalization, we believe the scope of the consultation paper to be comprehensive.

We commend the regulators for putting together a thoughtful consultation, and appreciate the opportunity to provide our comments. Please feel free to contact us with any questions or requests for clarification.

Respectfully,

Heather Killian
CIBC World Markets Inc.
Heather.killian@cibc.com