Buy Side Investment Management Association
31 Adelaide Street East
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May 13, 2019

Autorité des marchés financiers
Alberta Securities Commission
British Columbia Securities Commission
IIROC
Ontario Securities Commission

c/o The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto ON M5H 3S8
comments@osc.gov.on.ca

-and-

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Montréal PQ H4Z 1G3
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-and-

IIROC
Kevin McCoy
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
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kmccoy@iiroc.ca

Dear Sirs and Madams:

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

The Buy Side Investment Management Association ("BIMA") is pleased to make this submission on Consultation Paper 23-406 – Internalization within the Canadian Equity Market.

BIMA was founded by, and represents, investment buyers from, predominantly, Canadian financial firms. Our members include bankers, corporate investors, fund managers, government investors and pension managers. Our mission is to provide our members with a community where buyside traders and

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investors engaged in trading Canadian equity markets can connect with their peers, exchange ideas and information, and learn ways to enhance performance.

We thank you for seeking consultation and input from industry professionals as you engage in policy formation. We applaud your efforts and hope there continues to be open and mutually beneficial dialogue between regulators and industry in this area.

Our high-level concerns and comments can be summarized as follows:

It's our belief that increased rates of internalization leads to fragmenting of the equity marketplace, a reduction in price discovery, and if left unchecked, raises questions around market integrity. In a country as small as Canada's equity market is, when compared to the world stage, an increase in internalization, or any activity that pulls the market apart will result in a diminished capability to match trades. This reduced capability for matching as order flow is fragmented will reduce price discovery.

Incentives drive behaviour. Exchanges can drive behavior through their use of rebate fees such as the TSX increasing rebates for liquidity takers on the Alpha Exchange. For other exchanges that are competing only on costs, there is even more incentive to offer ever increasing rebates (there is no limit on inverted markets) that will continue to create even more fragmentation. A danger here is that retail order flow will be directed to these exchanges even more that could drive a further separation between liquidity providers, generally institutional flow, and liquidity takers, generally retail flow. Fee sensitive routers will direct trades to these exchanges accordingly, further segmenting order flow and harming price discovery. Incentives such as this could lead to more internalization by dealers as they manage their trading costs.

Responses to Questions for Market Participants

You will find below our response to the questions set forth throughout the Consultation Paper. For ease of reference, we have reproduced each question in italics preceding the applicable comment.

1. How do you define internalization?

We define internalization as the practice of dealers trading against their own orders. These trades are conducted without exposing the orders to book priority and goes against the practice of fair access.

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 believe these attributes are relevant considerations from a regulatory policy perspective.

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.

Increasing rates of internalization will provide a level of harm to each of these attributes. With lack of transparency and price discovery occurring questions will be raised about the fairness of

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the markets. As this spills over it's reasonable that market integrity will be called into question. This is not a path the Canadian equity marketplace can afford to take.

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

As members of BIMA we have a fiduciary duty to our asset owners to manage their assets to the best of our ability in the current market environment. It's fair to say the common good is in our interest. Having best execution driven by transparency, fair access and price discovery helps to satisfy this fiduciary duty. However, we also realize not all actors in the market are driven in their actions by the common good but rather, as for-profit enterprises, are more likely driven by their individual good and what drives their operations. There is a balance somewhere in the middle that, while neither side would be wholly satisfied, neither would they be wholly unsatisfied.

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.

Nothing to add here.

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).

Nothing to add here.

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

As your statement in the Consultation Paper reads we are also not aware of any studies completed or evidence to show that market quality has been negatively impacted by broker preferencing. As participants in the markets we see both good and bad with this approach. At times the additional transparency is good for the common use and at times transparency is not as good for the individual use. Our challenge as actors in this market is that our position will change from trade to trade. However, we do have a worry that alternatives to broker preferencing could lead to a U.S. style approach to trading retail flow and/or greater fragmentation. Neither of these potential outcomes could be expected to provide greater transparency and/or price discovery.

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).

Nothing to add here.

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

Preferencing trades increases the ability to internally cross trades within a dealer. The larger number of trades a dealer has the greater the benefit of internally crossing. Therefore, larger dealers, through larger trade volume, should benefit more from broker preferencing.

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

We're not aware of any studies that cover this area.

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?

Using the Interpretation of the Definition of a Marketplace as outlined in the Consultation Paper section 4.3 would suggest to us no. But, similar to what is outlined, new technology matching abilities should cause us to rethink what is a marketplace. The question to answer here is whether defining trades that are internalized orders, would they lead to price discovery.

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?

As outlined in our response earlier we firmly believe segmentation of order flows is a concern. Actions from market participants through internalization, fee sensitive approaches, of other actions that impair price discovery and transparency is an obstacle to our fiduciary responsibility to our asset owners.

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?

Yes.

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.

No.

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

No.

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Concluding Remarks

At times various members of our organization will benefit from internalization and at times various members of our organization will not benefit from internalization. Somewhere there is a medium that is more beneficial to the common market participant than any one individual market participant. It's our view striking the right balance to not have incentives drive behaviour toward any outcome that does not benefit the greater good should seriously be reviewed. If incentives or behaviours are not beneficial for the common good, they should not be implemented.

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view.

Yours truly,

Brent Robertson
President, BIMA