

Monday, September 10, 2018

By ELECTRONIC MAIL: legal@aequin.com

Cindy Petlock
Chief Legal Officer & Corporate Secretary
Aequitas NEO Exchange Inc.
155 University Avenue, Suite 400
Toronto, ON M5H 3B7

Re: Aequitas NEO Exchange Request for Comments – Proposed Trading of Foreign Listed Structured Products

Bank of Montreal, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and The Toronto-Dominion Bank (“we” or the “Banks”) appreciate the opportunity to comment on this proposal.

Together, the Banks are the principal issuers of structured product notes in Canada. Therefore, we take great interest in any new regulatory initiative relating to structured product notes and its potential impact on investors.

Aequitas NEO Exchange Inc. (“NEO”) proposes to offer for trading foreign-listed structured products (“Foreign-Listed Structured Products”) on an unlisted basis (cross trading) to Canadian investors (the “Proposal”).

Rationale

In its request for comments, NEO states that Canadian investors do not have easy access to a competitive market of structured product notes, that current access is limited to those securities offered on a bilateral basis by their financial institution, that there is little to no transparency with respect to pricing and that it is difficult to deploy dynamic investment strategies.

We disagree with the rationale provided by NEO with regards to the Proposal. Canadians already have access to a variety of high quality structured products which are offered by several issuers. These issuers are constantly competing to offer better economic terms, strategies and features to Canadian investors.

With respect to the dynamic investment argument, structured notes are generally designed for the Canadian marketplace as buy-and-hold investments. While good liquidity is generally available in most Canadian structured product notes, intra-day trading is not a material consideration for investors. Further, since the Banks represent some of the largest Canadian market participants, we are committed to maintaining a liquid and efficient daily secondary market for our investors. We also share the concern that bid spreads will widen when the listing exchange is closed for the day or the liquidity provider is not active, as mentioned in the NEO’s notice. We believe that no compelling argument is made by NEO with respect to the fact that Foreign-Listed Structured Products would provide better pricing transparency. On-exchange liquidity in most of these ETNs is provided by the ETN issuer, and no other potential liquidity provider is likely to be motivated to increase the depth of this market.

More importantly, we are concerned that offering Foreign-Listed Structured Products for trading where they would not be regulated by Canadian securities authorities could be detrimental to public investor protection and unfair from a competition standpoint for the Canadian Banks, as discussed below.

Investor Protection

Pursuant to *National Instrument 21-101*, an investor buying a Foreign-Listed Structured Product through cross trading would not receive a prospectus and may not even have access to such document in English or French. This will result in avoidance of Canadian securities laws, and the standards required by Canadian securities regulatory authorities, both in form and substance, may not be applied.

We also have concerns about the creditworthiness and commitment of issuers of Foreign-Listed Structured Products to the Canadian market, as explained further below.

Regulatory Environment

The offering of structured notes in Canada is regulated by numerous rules and requirements designed to protect investors. These include, in particular:

- Prospectus-level disclosure regarding the issuer and the structured product notes
- Pre-clearing of “novel” products with regulators
- Restrictions on the types of underlying structure
- Restrictions on the types and home jurisdiction of underlying interest
- Disclosure requirements regarding fees and expenses, underlying interest performance data, calculation examples, on-going information and conflicts of interest
- Restrictions on the marketing materials provided to investors
- Scheme of statutory civil liability for primary market disclosure
- Scheme of statutory civil liability for secondary market disclosure
- French language disclosure requirements for investors in Québec

NEO’s notice provides that it will only consider for cross trading notes that have been listed for a duration that is the lesser of three months and 10% of their term, the latter as published at the time of listing. We believe that cross-trading Foreign-Listed Structured Products in such a short period following their issuance creates the potential for indirect offerings into the Canadian marketplace without compliance with the requirements applicable to Canadian public offerings of securities and the investor protections that come along with those requirements.

Investors in Foreign-Listed Structured Products may not be sent prospectus-level disclosure regarding the products. As a result, Canadian investors would not have access to important information such as tax disclosures that are addressed specifically to Canadian investors in a Canadian public offering. This tax information may not be found in the documentation of Foreign-Listed Structured Products and can be complex, and it could prove challenging for Canadian investors to produce their tax statement without guidance. Even after their issuance, structured product notes sometimes call for continuous information and notices to holders that may not reach Canadian investors in Foreign-Listed Structured Products.

Moreover, restrictions regarding the use and content of marketing materials for structured notes would not apply to Foreign-Listed Structured Products under the Proposal.

Furthermore, Canadian investors purchasing Foreign-Listed Structured Products on NEO would not have any rights of action in Canada against Foreign-Listed Structured Products issuers for misrepresentations in offering and marketing materials, nor would they enjoy any rights of action with regards to secondary market disclosure.

Canadian regulators have closely followed the regulatory environment relating to structured product notes and have enhanced their requirements over the years to ensure the protection of investors. These include restrictions on the types of underlying interest used, the information disclosed, and the types of structures available.

Canadian regulators have made clear that certain types of underlying interests such as investment funds and proprietary indices would be scrutinized, and have restricted issuers from issuing structured notes linked to equity securities of foreign issuers that are not reporting issuers in Canada and are not listed on a Canadian stock exchange. A pre-clearing process exists to regulate linking to foreign issued securities, and this would not apply to Foreign-Listed Structured Products.

Canadian regulators restrict the use of back-tested performance data and have specific rules about hypothetical calculation examples, and the disclosure of fees and expenses. These tend to be key features considered by investors in making their investment decision.

Canadian regulators have also imposed specific safeguards regarding (i) valuation for structured products using fixed income securities as underlying interests, (ii) structured product notes using quantitative models as underlying interests and (iii) conflicts of interests that may arise within an issuer of structured product notes. None of these restrictions and safeguards designed for investor protection to Canadian standards would be required from issuers of Foreign-Listed Structured Products under the current Proposal.

Regulators have also issued guidelines regarding the maintenance of dedicated web sites and timely publication of key information regarding structured products following their issuance, which may not be available to investors in Foreign-Listed Structured Products under the Proposal.

The structure types for structured product notes offered by issuers in Canada have been pre-cleared by regulators. However, novel structures of Foreign-Listed Structured Products would not be pre-cleared or filed with the relevant Canadian securities regulator pursuant to the requirements of *National Instrument 44-102*. This could lead to overly complex structures being introduced into the Canadian marketplace that could be inappropriate for a relatively conservative investor base in Canada.

In addition, it will be necessary for NEO to market and promote the Foreign-Listed Structured Products to support trading and generate public interest for this new line of business. Yet, investors and advisors will likely not receive suitable education or disclosure about material attributes of such products. Foreign-Listed Structured Products could introduce different terminology, structures, risks and issuer creditworthiness that could create confusion for Canadian investors. The Canadian banks are active in product education, and dedicated to after-sales support for clients seeking guidance on a wide variety of matters, most notably performance expectations and tax implications of their investments in structured notes.

Creditworthiness and Commitment of Foreign Issuers

Foreign-Listed Structured Products have the potential to be highly complex financial products offered by issuers that may not be as committed to Canada or as creditworthy as the Banks. While we certainly have the capacity to manufacture structured products of a more complex nature, the Banks have tailored the product offerings to the needs of Canadian investors, Canada being on the conservative end of the spectrum when it comes to structured product notes. Therefore, the Banks have resisted added complexity to safeguard the reputation and strength of our industry. Due notably to their limited presence and activities in Canada and the fact that these are not listed securities in Canada and that European issuers are not reporting issuers in Canada, European issuers are not bound or required to comply with local standards.

Additionally, we are concerned that if the Proposal fails and there is insufficient interest in the Canadian market, foreign issuers will have no incentive whatsoever to continue supporting this business for existing investors. The Banks, however, have a variety of interests that motivate them to provide good service to Canadian investors since we have meaningful economic and reputational stakes in Canada.

Regulatory Arbitrage

Secondary to the significant concerns regarding investor protection, we believe that the Proposal may create regulatory arbitrage for the industry in Canada. As stated above, NEO's notice provides that it will only consider for cross trading notes that have been listed for a duration that is the lesser of three months and 10% of their term. By making Foreign-Listed Structured Products available so early in their lifetime, we are concerned that foreign issuers may indirectly gain access to Canadian capital in a similar fashion to a primary issuance while avoiding the regulatory burden and liability of doing so. There is a possibility that such Foreign-Listed Structured Products could indeed be targeted specifically for the Canadian market.

Meanwhile, the Banks have expensive Canadian regulation to observe, which includes filing a prospectus in all provinces, complying with a lengthy and costly pre-clearance review process for any novel feature in new products and paying regulatory fees across Canada. Under the Proposal, Foreign issuers would also have more flexibility to introduce new and complex products without the need to comply with the requirements and guidelines set forth in CSA Staff Notice 44-304 - *Linked Notes Distributed Under Shelf Prospectus System* and CSA Staff Notice 44-305 - *Structured Notes Distributed Under the Shelf Prospectus System*.

The net effect of the above will be significant disruption to a market that has developed cautiously to meet and protect the needs of Canadians. Current market participants have invested significantly to establish note issuance programs within the regulatory framework to ensure Canadians have suitable investment solutions available to them with all the necessary information to make informed investment decisions.

We also believe that the implementation of the Proposal could generate significant operational challenges for the dealers and advisors. Amongst such challenges lies the necessity to respect suitability obligations and "Know Your Product" guidelines, which could be hard to implement and enforce with Foreign-Listed Structured Products.

In our view, the potential consequences of offering complex financial products such as Foreign-Listed Structured Products to retail Canadian investors should be carefully considered. When it comes to foreign financial products like Exchange Traded-Funds or ETNs, the OSC rightfully states in *Staff Notice 81-715 Cross-Listing by Foreign Exchange-Traded Funds* that a balance needs to be found between investor access to foreign products and investor protection while maintaining consistent regulation across domestic and foreign products. To that effect, we cannot support the Proposal, as we feel the added complexity created for Canadian investors outweighs any potential benefits claimed by introducing Foreign-Listed Structured Products into an already deep and competitive marketplace. The Canadian regulatory environment and structured products industry currently enjoys an enviable reputation due to the high-quality of the Canadian Banks, their profound commitment to education and client support, and the variety and quality of the products they make available to investors.

We do support new issuers wishing to list their products on the NEO, or any other exchange, in Canada. However, any new initiatives should be thoroughly vetted and considered with the best interests and protection of Canadian investors in mind. We believe that to properly do so, any issuer should have to comply with Canadian securities regulations.

The Banks appreciate the opportunity to comment on this Proposal which may carry serious consequences for investor protection. We look forward to our continued participation in any further consultation on the topic.

cc: Market Regulation Branch;
Corporate Finance Branch;
Investment Funds and Structured Products Branch
Ontario Securities Commission 20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8
e-mail: marketregulation@osc.gov.on.ca

cc: Autorité des marchés financiers, 800 Square Victoria, 22nd Floor, Montréal, QC H5Z 1G3

[Signatures on following pages]

Bank of Montreal

By:  _____

Abid Chaudry
Managing Director

Authorized Signatory

Canadian Imperial Bank of Commerce

By: 

Name: *W. B. AMBLED.*
Managing Director.
Authorized Signatory

National Bank of Canada

By: _____
Name:

Authorized Signatory

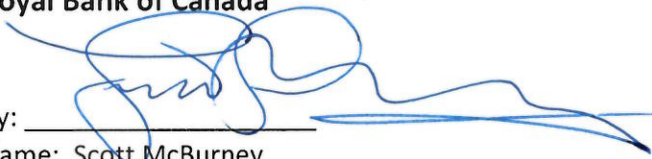
National Bank of Canada

By: 

Name: François Bourassa
Senior Manager (Supervisory)
Trading and Structured Products

Authorized Signatory

Royal Bank of Canada

A handwritten signature in blue ink, appearing to be 'Scott', written over a horizontal line.

By: _____

Name: Scott McBurney

Authorized Signatory

The Toronto Dominion Bank

By:  _____

Name: *David Panko,
Managing Director, Global Head of Equity Derivatives*
Authorized Signatory