BMO Financial Group

Via Email

January 10, 2022

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
comments@osc.gov.on.ca

Re: OSC Staff Notice 33-753: OSC Consultation on Tied Selling and other Anti-Competitive Practices

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We are writing on behalf of BMO Financial Group in response to the request for submissions set out in *OSC Staff Notice 33-753 – OSC Consultation on Tied Selling and other Anti-Competitive Practices in the Capital Markets*.

We support initiatives that foster effective capital formation, ensure robust competition for capital markets services and promote both the efficiency of, and confidence in, our capital markets. Accordingly, we welcome the opportunity to make submissions on the issues set out in the Notice.

We understand that the request for submissions is in response to concerns raised by the Capital Markets Modernization Taskforce that certain commercial lenders may be engaging in practices that may impede competition, such as arrangements where a lender requires issuer clients to retain the services of an affiliated dealer or adviser for their capital raising and/or advisory needs, as a condition of the lending transaction, or vice versa, known as tied selling.

Anti-competitive practices can harm the efficiency of, and confidence in, our capital markets. In that regard, we note that tied selling is currently prohibited by existing provisions in the *Bank Act* and *National Instrument 31-103*. As a Canadian bank, we take our regulatory obligations seriously and are required to have an effective compliance program that takes these and other requirements into account.

We, however, are not supportive of the Taskforce proposals that are aimed at limiting the ability of lenders and affiliated dealers from bundling lending and advisory services to meet the needs of clients as (i) existing requirements sufficiently restrict exclusivity arrangements and address underwriter conflicts; (ii) we believe there is substantial competition for capital markets services in Ontario; and (iii) these proposals would increase the cost of wholesale financial services, reduce customer choice and access to bank capital and may not ultimately benefit Canada's independent dealers.

The Taskforce proposals would limit or prohibit banks' ability to provide preferential pricing for bundled products and services, which are frequently requested by clients rather than at the initiative of dealers. As a result, these restrictions would increase costs of financial services for issuers and their investors who benefit from preferential pricing. In addition, lending relationships with many clients may be unattractive to financial institutions if, by entering those relationships, it would limit the ability to also provide advisory or underwriting services. As a result, these clients may have less access to bank capital.

Further, complicated capital markets transactions often involve multiple products offered simultaneously, which requires extensive capital commitment that large Canadian dealers are well positioned to arrange. We note that,

since 1992, the *Bank Act* has permitted Canadian banks, or affiliates, to provide advisory and underwriting services to meet both the lending and advisory needs of clients.

Canadian capital markets clients generally have access to global capital. If large, diversified Canadian financial institutions are limited in their ability to offer financial services to these clients, they will raise capital outside Canada through other large U.S. and international financial institutions. As a result, the main beneficiaries of the Taskforce proposals may be these U.S. and international financial institutions, rather than Canada's independent dealers.

We understood from the Taskforce that its proposals sought to address a perceived decline in capital raising activities for venture issuers and smaller independent dealers. We do not believe that there has been such a decline. Since 2005, bank-owned dealers' market share by deal value in the Canadian market has decreased by approximately 38%, while both international banks and independent broker dealers have gained market share, approximately 27% and 11%, respectively. This data shows that the current regulatory regime is not impairing competition in the Canadian market for independent broker dealers. If there is any decline in capital raising activities for venture issuers and certain smaller independent dealers, we do not believe non-compliance with existing tied selling provisions, or bundling and preferential pricing practices are the root cause of any decline. We believe that any challenges faced by independent dealers can be attributed to:

- a shift in capital markets away from higher risk venture issuers;
- less competitive pricing by smaller independent dealers;
- an increasing shift from public markets to private equity as a source of capital; and
- a move to international markets for capital raising as a result of globalization.

For the reasons set out above, we do not support the Taskforce proposals in the Appendix to the Notice. Our responses to the specific questions set out in the Notice are set out below.

1. Is there evidence of commercial lenders requesting issuer clients to retain the services of a dealer or adviser affiliated with the commercial lender to assist with the issuer's capital raising and/or advisory needs, or vice versa? If yes, please provide particulars.

Banks, and affiliates, offer bundled products and services to clients in compliance with existing tied selling provisions in the *Bank Act* and *National Instrument 31-103*. This is often at the request of clients seeking preferential pricing but is also offered by banks, and affiliates. In addition, complicated capital markets transactions often involve multiple products offered simultaneously, which requires extensive capital commitments that large Canadian dealers are well positioned to arrange. Accordingly, banks, and affiliates, often provide multiple products and services to clients to meet their capital raising and/or advisory needs.

Bundling of services or relationship pricing is not offered as a requirement or condition of financing as this is prohibited by existing tied selling provisions in the *Bank Act* and *National Instrument 31-103*.

Preferential pricing arrangements are not based on a minimum amount of business but rather a commercial arrangement determined by the scope of the bundled products and services being offered and is generally a client driven arrangement.

These arrangements do not include a condition that the client does not retain or discontinues the use of services provided by any other dealer or adviser, such as a dealer or adviser affiliated with a competitor.

2. To the extent there is evidence of commercial lenders requesting issuer clients to retain the services of an affiliated dealer or adviser, please explain the nature of the request. Specifically,

(a) Can the request reasonably be characterized as "bundling" of services or "relationship pricing", which is specifically contemplated and permitted by the Bank Act and NI 31-103?

See response to 1 above.

(b) Can the request reasonably be characterized as a requirement or condition of financing; namely that the commercial lender would only make available a credit facility, or a credit facility at a more favourable cost, if the issuer client retained the services of an affiliated dealer or adviser?

See response to 1 above.

(c) Did the request require a minimum amount of business be allocated to the affiliated dealer or adviser?

See response to 1 above.

(d) Did the request include a condition that the issuer not retain or discontinue the use of services provided by any other dealer or adviser, such as a dealer or adviser affiliated with a competitor of the commercial lender?

See response to 1 above.

3. Some commenters have suggested that, if improper tied selling is occurring, this should be addressed through existing enforcement mechanisms such as the Competition Act, the Bank Act and/or NI 31-103. Do you feel this is an effective way to deal with the potential concerns outlined in this Notice? If not, why not?

As tied selling is currently prohibited by the *Bank Act* and National Instrument 31-103, existing provisions sufficiently address tied selling. In addition, the *Competition Act* provides a legislative framework for the Competition Bureau to address business activities, including tied selling, which may negatively impact competition in a relevant market. The existing MOU between the OSC and the Competition Bureau facilitates cooperation between the two agencies should either want to address potentially anti-competitive activities in the capital markets.

4. Some commenters have suggested that the recommendations of the Taskforce contained in the Final Report (reproduced in Appendix A) will, if adopted, restrict issuer choice and negatively impact capital raising and/or simply benefit foreign dealers at the expense of Canadian dealers. Do you agree or disagree with these comments? Please explain.

We agree that the Taskforce recommendations will, if adopted, restrict issuer choice and negatively impact capital raising and/or benefit foreign dealers at the expense of Canadian dealers.

Limiting or prohibiting our ability to bundle products and services, which is frequently requested by clients, would increase the costs of financial services for clients as they would not benefit from preferential pricing. Further, lending relationships with many clients would be unattractive to financial institutions if, by entering those relationships, it would limit the ability to also provide advisory or underwriting services. As a result, these clients may have less access to bank capital.

Canadian capital markets clients generally have access to global capital. If large, diversified Canadian financial institutions are limited in their ability to offer financial services to these clients, they will raise capital outside Canada through other large U.S. and international financial institutions. As a result, the main beneficiaries of this

proposal may be these U.S. and international financial institutions, rather than Canada's independent dealers, as complicated capital markets transactions often involve multiple products offered simultaneously, which requires extensive capital commitment that large dealers are well positioned to arrange. If there is any decline in capital raising activities for venture issuers and certain smaller independent dealers, we do not believe non-compliance with existing tied selling provisions, or bundling and preferential pricing practices are the root cause of this decline.

5. The Taskforce recommended that the Commission work with the Canadian Securities Administrators (the CSA) to amend National Instrument 33-105 Underwriting Conflicts and/or through the adoption of a local rule to require an independent underwriter in prospectus offerings in circumstances where the issuer would be considered a "connected issuer" to one or more of the underwriters involved in the offering by virtue of any commercial lending relationship between an affiliate of the underwriter and the issuer. Do you agree or disagree with this recommendation? Please explain.

We disagree with this recommendation and do not support the Taskforce proposal. Existing related and connected issuer rules sufficiently address potential underwriter conflicts through disclosure and independent underwriter requirements.

Where a bank is a lender to an issuer and underwriter, existing rules provide for full disclosure of any relationship that affects the issuer and underwriter's independence from one another in a distribution, which sufficiently addresses the potential for conflict and provides appropriate disclosure.

The effect of this proposal would be to significantly limit underwriting activities of bank-owned dealers. As a result, it will significantly reduce banks', and their affiliates', ability to provide preferential pricing for bundled products and services which will increase the costs of financial services for clients. In addition, lending relationships with many clients would be unattractive to financial institutions if, by entering those relationships, it would significantly reduce the ability to also provide advisory or underwriting services. As a result, these clients may have less access to bank capital.

In addition, issuer choice would be significantly restricted. As large corporate loans in Canada are often syndicated amongst several banks, the proposals would effectively restrict issuers when seeking to retain most large Canadian dealers in their capital raising activities.

6. The Taskforce also recommended that, where a registered firm provides capital markets services to an issuer and also has an affiliated commercial lender, there should be a ban on certain restrictive clauses in capital markets engagement letters. This includes agreements that restrict a client's choice of future providers of capital market services (as defined above), such as "right to act" and "right of first refusal" clauses, where a commercial lending and capital markets relationship exists. Do you agree or disagree with this recommendation? Please explain.

We disagree with this recommendation. Restrictive clauses are typically only used in advisory or capital raising engagements and are industry practice in the Canadian market due to the nature of bundling current services to a client with preferential pricing on the understanding of being retained on future advisory or capital raising engagements. In some cases, banks do a significant amount of work for clients which is not directly compensated. This is on the understanding that the bank will be engaged on future work which will attract fees. Removing a "right of first refusal" or "right to act" clause could have the consequence of obliging clients to pay for financial services up front and increase the overall cost of financial services for clients. Bundling of services or relationship pricing is not offered as a requirement or condition of financing as this is prohibited by existing tied selling provisions in the *Bank Act* and *National Instrument 31-103*.

7. Are there any other practices that commercial lenders and their affiliated firms are engaging in that are negatively affecting competition in the Ontario capital markets?

We are not aware of any evidence demonstrating that bundling and/or preferential pricing practices are negatively affecting competition in the Ontario capital markets. The final report of the Taskforce did not establish that customers of capital markets services in Ontario are paying more than they should in a competitive market, or are not benefitting from adequate choice and innovation in products and services.

8. Are there regulatory changes that the Commission should consider to increase competition for capital markets services in Ontario?

We believe that there is substantial competition for capital markets services in Ontario and that no regulatory changes are therefore required.

We appreciate the opportunity to make submissions on the issues set out in the Notice and would be pleased to discuss our responses with you.

Yours truly,

Dan Barclay
Chief Executive Officer &
Group Head, BMO Capital Markets