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September 16, 2015

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Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

c/o

The Secretary
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Fax: 416-593-2318
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Dear Sirs/Mesdames:

CSA Notice and Request for Comment – Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery

This letter is in response to the CSA Notice and Request for Comment – *Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery – Proposed Amendments to NI 41-101 General Prospectus Requirements and to Companion Policy 41-101CP to NI 41-101 General Prospectus Requirements and Related Consequential Amendments* (2015) 38 OSCB 5509 (the "**Proposed Amendments**").

This letter reflects the comments of certain members of Osler, Hoskin & Harcourt LLP's Investment Funds and Asset Management Practice Group and does not necessarily reflect the overall views of our firm or our clients.

We are generally very supportive of the Proposed Amendments but would like to take this opportunity to offer the following comments on a select number of issues relating to them:

1. The ETF Facts is substantially similar to the Fund Facts, except for additional information related to trading and pricing (e.g., average daily volume, number of days traded, market price range, net asset value range, average bid-ask spread and average premium/discount to NAV). We seek specific feedback on these proposed elements of the ETF Facts. In particular, please comment on the disclosure instructions for these elements as outlined in Form 41-101F4. For example, should the range of market prices exclude odd lot trades? In terms of the calculation of the average bid-ask spread, should trading days that do not have a minimum number of quotes be excluded from the calculation? We also seek feedback on whether there are alternative methods or alternative metrics that can be used to convey this information in a more meaningful way for investors.

Average Premium/Discount to NAV

Similar to closed-end funds, but unlike conventional mutual funds, there are two prices for exchange-trade fund ("**ETF**") securities at any given point in time: the primary market price (i.e. the net asset value ("**NAV**")) for the purposes of creations and exchanges, and the secondary market price (i.e. the prevailing exchange bid and ask price) which is the price at which investors typically acquire and dispose of their ETF securities.

The fact that an ETF can trade at a premium or discount to NAV is sometimes viewed as a failure of the ETF mechanism. However, there are often healthy reasons for the existence of premiums or discounts, particularly for ETFs that have exposure to international or fixed income securities. In order for an investor to properly evaluate the premium/discount disclosure proposed, it is therefore imperative that they understand the inherent limitations of NAV and that NAV is sometimes an imperfect estimate of the fair value of a fund. NAV is a static calculation that is generally based on end-of-day pricing sources, whereas market price trades in real-time and reflects current and forward-looking valuations. This is especially true for ETFs holding international securities where apparent ETF premiums and discounts typically reflect price discovery and the ability to trade the ETF securities in real time. For example, ETFs can be used to express a market view on international securities even when their underlying markets are closed.

In addition, apparent premiums and discounts on securities of fixed income ETFs may arise due to several factors, particularly the challenges of price discovery when valuing the portfolio assets in a primarily non-transparent, over-the-counter market. The NAV of a fixed income ETF is also typically based on either mid or bid market prices, and therefore does not directly reflect the bid/ask spread that exists in the market for each bond. ETF market prices, in contrast, do reflect this spread. The fact that bid/ask spread is observable in ETF market prices, but not in NAVs, can also contribute to differences between a fixed income ETF's market price and its NAV.

As a result, where there is a deviation between market price and NAV, it often has more to do with the NAV being calculated using static valuations of the underlying portfolio securities than with the exchange-determined intra-day market price of the ETF deviating from fair value. Without this deeper understanding – which is difficult to convey in a brief document such as an ETF Facts – many investors may draw incorrect conclusions from this disclosure, especially given that, in practice, ETF investors will not typically transact with an ETF at NAV. We therefore believe that the proposed ETF Facts disclosure overemphasizes the significance of NAV premiums and discounts with respect to ETFs and may incorrectly lead investors to believe that a premium or discount is inherently "good" or "bad", when, in fact, premiums and discounts are often healthy but are not inherently either "good" or "bad".

Moreover, ETFs incorporate a number of features that seek to minimize discrepancies between the market price and fair value such as the continuous distribution mechanism and the market-making roles played by designated brokers and other liquidity providers. Generally, because of the flexibility of the creation and exchange mechanism, liquidity providers are able to quickly meet demand to buy and sell ETF securities at appropriate prices relative to an ETF's NAV. In addition, the unique arbitrage mechanism of ETFs, which allows liquidity providers to profit from any mispricing between an ETF and its underlying holdings, helps to both keep market prices in line with the value of the ETF's underlying portfolio securities and to eliminate sustained premiums or discounts to NAV.

Therefore, we respectfully caution the Canadian Securities Administrators (the "**CSA**") from placing undue emphasis on NAV premiums/discounts in the ETF Facts as we believe this information is not particularly instructive for most investors and may lend credence to the myth that trading at a premium or discount to NAV is a shortcoming – rather than a positive feature – of the ETF mechanism.

Average Daily Volume and Number of Days Traded

We believe that, without a complete understanding of ETF liquidity and structure, requiring the disclosure of average daily volume and number of days traded may mislead investors as to an ETF's true liquidity. Focusing solely on the liquidity of the ETF security as if it was a conventional equity stock, while ignoring the liquidity of the ETF's underlying portfolio securities, may give ETF investors an incomplete picture of an ETF's liquidity as secondary market turnover discounts the ability of the primary market creation mechanism to meet demand. Although an ETF may have a low average daily volume or a relatively few number of days traded, underwriters can nevertheless create new ETF securities as needed to satisfy investor demand or, conversely, redeem ETF securities where there is little demand. As many Canadian ETFs do not trade on a daily basis, this may lead investors to mistakenly believe these ETFs are not liquid because they do not appreciate an ETF's creation/redemption mechanism; a mechanism which generally allows liquidity to be added as needed through primary market transactions with underwriters.

Average Bid-Ask Spread

We respectfully submit that focusing on average bid-ask spread, regardless of the size of trade, may be misleading for investors that place larger trades (i.e. outside "top of book") as the bid-ask spread often increases with the size of the trade. Instead, we suggest it may be more useful for investors to use a sample trade size (for example, show the average bid-ask spread for a $1,000 trade, which aligns with the amount used in connection with the proposed performance disclosure). We also suggest that this disclosure be moved under the heading "Trading information".

Finally, if the CSA proceeds with the inclusion of trading and pricing information such as average bid-ask spread, average daily volume and average premium/discount to NAV, we strongly encourage the CSA to clarify the calculation methodology that they expect to be applied in order to ensure both a level playing field across ETF managers and a clearer understanding by ETF investors. We note that, to the extent data is sourced from different data vendors, this may affect the consistency and comparability of the information across different ETF managers.

2. The "How ETFs are priced" section of the ETF Facts is intended to provide ETF investors with some additional information on the factors that influence trading prices and to explain the difference between market price and NAV. This section has been modified in response to investor testing, which showed that investors valued this type of information but were not necessarily aware of how to use it in practice. We seek feedback on whether there is an alternative form of presentation of this information that may better assist investors.

While we understand the underlying policy rationale of facilitating investor access to key information about an ETF in language they can easily understand, we have a concern that the proposed disclosure in Item 7 of proposed Form 41-101F4 – *Information Required in an ETF Facts Document* oversimplifies the relationship between market price and NAV of an ETF and overstates the significance of NAV premiums and discounts with respect to ETFs for the reasons described earlier in our response.

As discussed above, while the fact that an ETF can trade at a premium or discount to NAV is sometimes viewed as a failure of the ETF mechanism, our understanding is that, given that markets are imperfect, the ETF mechanism can actually facilitate an ETF's ability to provide liquidity at the intrinsic value of the underlying assets.

Rather than attempting to summarize the complex relationship between NAV and market price in a brief document like the ETF Facts, we suggest that the CSA instead publish an "ETF 101" document for investors (similar to the *Investing 101: Indices and Index Funds* publication the Ontario Securities Commission has previously released)[1], that provides guidance on ETF pricing and trading. This document could include a more nuanced and detailed discussion of market price and NAV, as well as some suggested best practices for trade execution (for example, avoiding placing trades early in the morning or late in the afternoon to limit volatility and advocating the use of limit orders rather than market orders).

In the alternative, if the CSA chooses to proceed with including the aforementioned disclosure, we recommend revising the language in Item 7 of proposed Form 41-101F4 per the blackline provided in Appendix A.

We thank you for the opportunity to comment on the Proposed Amendments and would be pleased to discuss them with you further. If you have any questions or comments, please contact John Black (416.862.6586; jblack@osler.com) or Shawn Cymbalisty (416.862.4244; scymbalisty@osler.com).

Yours very truly,

"Osler, Hoskin & Harcourt LLP"

Osler, Hoskin & Harcourt LLP

[1] http://www.osc.gov.on.ca/documents/en/Investors/inv_news_20150727_indices-index-funds.pdf

Appendix A
Form 41-101F4 - Information Required in an ETF Facts Document

Item 7 – Pricing
Under the sub-heading "How ETFs are priced", state the following:

ETFs are unique because they hold a basket of investments, like mutual funds, but trade on exchanges like stocks. For this reason, ETFs have two sets of prices: market price and net asset value (NAV).

Market Price [*in bold type*]

- You buy and sell ~~ETFs~~ETF securities at the market price on the exchange. The market price can change throughout the trading day. Factors like supply, demand, and changes in the value of the ETF's portfolio investments can affect the market price for an ETF's securities.
- You can get price quotes any time during the trading day. Quotes have two parts: bid and ask.
- The bid is the highest price a buyer is willing to pay if you want to sell your ~~units~~ETF securities. The ask is the lowest price a seller will accept if you want to buy ~~units~~ETF securities. The difference between the two is called the "bid-ask spread".
- In general, a smaller bid-ask spread means the ETF is more liquid. That means you are more likely to get the price you expect.

Net Asset Value (NAV) [*in bold type*]

- Like mutual funds, ETFs have a NAV. It is calculated after the close of each trading day and reflects the value of the ETF's investments at the point in time when it was calculated.
- NAV is used to calculate financial information for reporting purposes – like the returns shown in this document.
- If the market price is lower than the NAV, the ETF ~~is~~'s securities are trading at a discount. If the market price is higher than the NAV, the ETF ~~is~~'s securities are trading at a premium. If you sell an ETF at a discount, you may be getting less than its investments are worth. If you buy an ETF at a premium, you may be paying more than its investments are worth. Premiums and discounts may also result from changes in the value of the ETF's investments that have not yet been reflected in the ETF's NAV. Since ETF's continuously offer their securities, it is generally unlikely that large premiums or discounts to NAV would be sustained.