



**Canadian Bond  
Investors' Association**

**Association canadienne des  
investisseurs obligataires**

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British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Financial and Consumer Services Commission (New Brunswick)  
Nova Scotia Securities Commission  
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island  
Securities Commission of Newfoundland and Labrador  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Nunavut

c/o Debra Foubert  
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Dear Sirs and Mesdames:

## **Issues Disrupting the Investment Activities of Canadian Institutional Bond Investors**

The Canadian Bond Investors' Association (the "CBIA") represents 48 of the largest fixed income institutional investor organizations in Canada, with over \$850 billion in fixed income assets under management. Our member organizations include sophisticated institutional investors such as insurance companies, bank-owned investment managers, pension funds and investment advisers. Our mandate includes acting on behalf of institutional fixed income investors in addressing key issues with legislators, regulators, bond issuers, investment dealers and other industry participants. We are the voice of Canadian bond investors, and speak not only for those investors but also for the pensioners, policy holders and retail investors who depend on our members for the sound management of their investments.

We are writing to urge the Canadian Securities Administrators (the "CSA") to take immediate action to resolve two different, but equally problematic, regulatory issues that are preventing CBIA members from trading in fixed income securities in a manner that they consider necessary and appropriate for the proper management of their investment portfolios.

The first issue dates back to 2015, when changes to National Instrument 31-103 of the CSA ("NI 31-103") were introduced which prevented foreign dealers operating under the "international dealer" exemption from concurrently holding registration as exempt market dealers or restricted dealers. Since those changes came into effect, our members have been frustrated in their efforts to trade in certain fixed income securities of Canadian issuers. The problem arises as a result of the fact that international dealers have surrendered their exempt market dealer or restricted dealer registrations so that they may continue to use the international dealer exemption. In consequence, they can no longer engage in secondary market trading activities with Canadian investors for any Canadian issuer bonds, including Canadian bonds that were initially offered primarily outside Canada by foreign dealers. While Canadian registered dealers are legally permitted to engage in secondary trading of those bonds with Canadian investors, they have little incentive or ability to make a market for those securities in Canada, and are not readily able to execute trades in the foreign market where liquidity exists. We refer to this as the "NI 31-103 Problem".

The second issue has arisen recently as a result of changes to the requirements for reporting exempt distributions under National Instrument 45-106 of the CSA ("NI 45-106") which came into effect on June 30, 2016. Those changes have prevented members of the CBIA, and other large Canadian institutional investors, from participating in U.S. and other global bond offerings. We refer to this as the "NI 45-106 Problem".

### **The NI 31-103 Problem**

We have had a number of informal discussions with Staff of the Ontario Securities Commission since the Fall of 2015 to voice our concerns about the NI 31-103 Problem and the negative impact it has had on the ability of Canadian investors to transact in bonds initially issued by Canadian issuers primarily in markets outside Canada.

Following our annual general meeting in April 2016, we conducted a survey of our members about the impact of the NI 31-103 Problem on them, seeking information about how secondary market liquidity had been affected, and the extent to which they viewed the NI 31-103 Problem as interfering with their ability to discharge their fiduciary responsibilities to Canadian retail and institutional investors by preventing them from making appropriate portfolio investments. We received almost a 100% response rate from members of our association. Approximately 64% of the respondents stated that the NI 31-103 Problem has negatively affected them. All of the respondents believed that market liquidity for secondary market trading of U.S. dollar denominated bonds issued by Canadian issuers has decreased.

In addition to its impact on our members, we expect that the NI 31-103 Problem will also increase the cost of raising debt for Canadian bond issuers (and, particularly, debt denominated in U.S. dollars) due to decreased demand for those bonds from Canadian institutional investors because of the NI 31-103 Problem. Approximately 93% of our members indicated they would not participate in new bond issuances by Canadian issuers offered primarily outside Canada, absent an offsetting pricing discount to compensate for the secondary market trading difficulties they anticipate.

The majority of our members believe that Canadian registered securities dealers are not able to provide a satisfactory substitute for access to U.S. dealers for secondary market trading in Canadian issuer bonds that were originally offered primarily in the United States. Even large Canadian investment banks do not have sufficient personnel, capital, risk appetite or expertise to be able to participate in the U.S. or other global fixed income markets in a meaningful way. Examples are Valeant Pharmaceutical and Bombardier, Canadian issuers which have traditionally been active in the U.S. bond market and have conducted U.S.-denominated bond offerings led by U.S. dealers. U.S. dealers have the highest volume of secondary market trading in Valeant Pharmaceutical and Bombardier bonds of any dealer worldwide. Even if willing and able to execute secondary market trades in those bonds, no Canadian dealer could provide the same level of information about trading activity, and quality of execution of trades, as the U.S. dealer with the greatest volume of trading in those bonds globally. We understand that as a result of the NI 31-103 Problem, many large global investment banks such as Goldman Sachs, Citi, Barclays, and Deutsche Bank have stopped trading Canadian bonds with Canadian investors. Canadian institutional investors in U.S.-dollar denominated bonds of Canadian issuers are no longer even able to get accurate information about the trading prices of those bonds in the United States, as the NI 31-103 Problem prevents international dealers from sending market information or quotes (e.g., Bloomberg runs) to Canadian investors.

It is very important for our members to be able to participate in primary offerings, or new issues, of fixed income securities as new issues are generally priced at a discount to existing secondary market trading prices for comparable bonds, creating the opportunity for superior investment returns for our members and their constituents. Traditionally, large institutional bond investors have made an effort to direct their secondary market trading orders to dealers known to lead a high volume of new issues, as those dealers have the ability to direct new issue allocations (which are often competitively sought after) to their most loyal, and profitable, secondary market trading clients. The NI 31-103 Problem has disrupted that traditional dynamic. Our members can no longer strengthen their relationships with U.S. and other foreign dealers through secondary

market bond trading of Canadian issuer bonds, as those dealers can no longer trade those bonds with Canadian clients on a secondary market basis. In consequence, those U.S. and other foreign dealers have less incentive to give priority to Canadian institutional investors when determining allocations of new bond issuances, whether they are bonds of a Canadian issuer being offered primarily outside Canada by an international dealer, or bonds of a U.S. or other foreign issuer being offered in Canada on a private placement basis.

Finally, our members who act as discretionary account managers for accounts holding Canadian bonds denominated in U.S. dollars (or otherwise originally offered primarily outside Canada) in their portfolios have been placed at a competitive disadvantage relative to U.S. and foreign investment managers such as Fidelity, Pimco and MFS Investment Management. Those foreign investment managers can now solicit portfolio management business as advisers or sub-advisers to Canadian institutional investors, promising better ability to manage and generate returns on portfolios holding those types of Canadian issuer bonds through their ability to transact in those bonds with U.S. broker-dealers, in contrast to their Canadian account manager counterparts who can no longer transact in those securities with U.S. broker-dealers on behalf of the accounts they manage.

### **The NI 45-106 Problem**

Since the adoption of the exempt trade reporting requirements under NI 45-106, our members have reported that their orders for new issues of foreign bonds have been refused by a number of non-Canadian securities dealers operating under the international dealer exemption in Canada. In particular, a large foreign dealer that is one of the most active in the new issue bond market appears to have suspended making any sales of bonds to Canadian investors in circumstances where private placement trade reporting would be required. While the Summer months are often less active for new bond issuances than other times of the year, we are very concerned that the problem our members have been facing will be compounded drastically as the volume of new bond issuances increases in the Fall.

As noted above in the discussion of the NI 31-103 Problem, it is very important for our members to be able to participate in primary offerings, or new issues, of fixed income securities as new issues are generally priced at a discount to existing secondary market trading prices for comparable bonds, creating the opportunity for superior investment returns for our members and their constituents. The NI 45-106 Problem is preventing them from participating in these offerings, jeopardizing their ability to implement investment decisions made in accordance with their fiduciary duties.

Our members are also very concerned about the impact that the NI 45-106 Problem will have on the "Maple Bond" market. As you are aware, Maple Bonds are Canadian-dollar denominated bonds issued by foreign borrowers in the domestic Canadian fixed income market. This market was practically non-existent until 2005, due to the foreign property rules which previously limited the percentage of foreign securities that could be held in the investment portfolios of certain Canadian institutional investors. The abolition of the foreign property rules in 2005, together with Canadian's positive financial environment, sparked a significant growth in the Maple Bond Market, with at least 100 Canadian institutional accounts having participated in

Maple Bond investments over the years. Maple Bonds are attractive to Canadian investors because they allow diversification of fixed-income holdings beyond the limited scope of Canadian issuer bonds available in the Canadian bond market, often with incremental yield relative to Canadian issues with similar credit ratings, while avoiding any foreign exchange risk. We believe that the NI 45-106 Problem puts the continued viability of the Maple Bond market at risk, as non-Canadian issuers and their investment bankers may be very reluctant to subject themselves to the new private placement trade reporting requirements.

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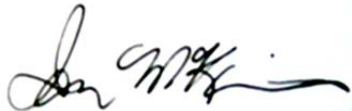
We believe that the NI 31-103 Problem and the NI 45-106 Problem are both unintended, and undesired, consequences of regulatory changes that were made for other very valid and well-intentioned reasons. However, whatever the motivation for those regulatory changes, they have introduced problems which must be corrected with great urgency.

The aftermath of the financial crisis of 2008 continues to linger, as global regulators, investors and issuers all remain greatly concerned with, and focused on, the efficient functioning of our Canadian capital markets. One necessary component is ensuring that Canadian investors have access to a transparent, efficient and liquid secondary market for corporate bonds of Canadian issuers, even if, in the case of bonds originally offered primarily outside Canada, that market is in the United States or elsewhere outside Canada. Another necessary component is encouraging U.S. and other foreign investment banks to provide Canadian institutional investors with much needed access to global bond offerings of U.S. and other non-Canadian issuers, rather than frustrating them through the imposition of bureaucratic reporting requirements and the risk of personal liability, or even potentially imprisonment, for providing inaccurate information about matters that are beyond their own knowledge and that are not relevant to any legitimate investor protection objective.

We urge the CSA to move quickly and decisively to rectify these issues. Failure to do so will result in the Canadian corporate bond market becoming less liquid, less fair, more inefficient and more cumbersome for investors, issuers and investment dealers.

Please feel free to contact the undersigned at [i.mckinnon@addenda-capital.com](mailto:i.mckinnon@addenda-capital.com) if you wish to discuss this letter with us, or if we can provide any more information that would be helpful to you in resolving the matters we have brought to your attention.

Very truly yours,



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