January 10, 2022

Delivered by email: comments@osc.gov.on.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, ON

Subject: Staff Notice 33-753

Ladies and Gentlemen:

We are writing in response to the recently published OSC Staff Notice 33-753 (the "Staff Notice"). We thank the Commission for inviting comments on this important topic and are pleased to present our perspective on the issues raised in the Staff Notice.

As you know, CIBC Capital Markets is a global capital markets business operating in both domestic and international equity and debt capital markets and provides a broad range of products and advisory services. CIBC strongly believes in the importance of deep, transparent and resilient capital markets in Ontario and in Canada. Robust and well-functioning capital markets can contribute to Ontario's economic recovery as well as its enhance its prosperity.

To this end, we were grateful to have had the opportunity to meet with members of the Ontario Capital Markets Modernization Task Force (the "Task Force") on several occasions in the course of their work to prepare their final report. We also had the opportunity to make written submissions to the Task Force, specifically our letter of September 4, 2020 (the "CIBC Task Force Letter"), which included our perspective on the issue of alleged tied selling in Ontario capital markets. We note that the issues raised in the Staff Notice appear to arise from Recommendation 34 (the "Recommendation") in the Task Force's final report.

At the outset, we wish to state that neither CIBC nor CIBC World Markets Inc. have been engaged in tied selling of the kind prohibited by the *Bank Act* or NI 31-103 and that the CIBC group of companies takes its obligations to comply with these requirements very seriously.

We have three principal submissions to make on the topic of tied selling, which largely mirror the concerns we raised with the Task Force following the publication of their Interim Report in July of 2020:

1. We believe that there is an important and intentional distinction between the concepts of tied selling and bundling.
2. We believe that the description of the competitive dynamics of the Ontario capital markets contained in the Recommendation is inaccurate.
3. We believe that regulators should not intervene in the operation of the market for capital markets services on the assumption that bank-owned dealers are incapable of providing high quality and independent advice to clients who have borrowed from their parent banks given the high standards of due diligence and myriad of conflict management procedures in place at such dealers.

We also would like to set out in this letter a few of our thoughts on the challenges facing Ontario investment dealers today and offer some policy suggestions on how to promote capital formation in Ontario and ensure the continuation of a deep and competitive marketplace for investment dealers to serve the needs of Ontario clients.

Tied Selling vs. Bundling

To begin, the Recommendation elides the important distinction between tying and bundling of capital markets and commercial lending products and services. We were pleased to see that the Staff Notice correctly makes this distinction and notes that bundling is expressly permitted under both federal banking legislation as well as NI 31-103.[1]

The distinction between legal and illegal tied selling is not accidental but a conscious choice of policy makers. As we noted in the CIBC Task Force Letter, regulators have expressly permitted the bundling of services and relationship pricing because these arrangements benefit the clients of investment dealers and advisers. It is important to remember that rules around tied selling exist to protect clients. These rules are not in place to protect the commercial interests of sellers of capital markets products and services whose value propositions to clients may be less compelling than those of their competitors. We respectfully submit that it is with an eye to clients' interests that Staff should be conducting the review requested by the Minister of Finance and ensuring that tied selling rules operate to their benefit rather than that of dealers.

Clients are able to use bundling to negotiate for more advantageous pricing and to provide incentives for dealers and banks to compete for clients based on price. In light of that reality, we urged the Task Force in the CIBC Task Force Letter to consult widely with issuers across a variety of industries in the Ontario market in order to obtain a comprehensive perspective on whether relationship pricing enabled dealers to provide more value to them. We made this comment because we were disappointed to see a relatively small number of issuers among the list of stakeholders consulted by the Task Force for its Interim Report. We reiterate our

[1] Sections 459.1(2) and (3) of the *Bank Act* expressly permit preferential pricing and the bundling of products and services. See also Section 11.8 of the Companion Policy to NI 31-103 which provides a similar safe harbour under securities law.

comments in the CIBC Task Force Letter that the views of larger institutional investors should be particularly sought out given their significant footprint in the Ontario capital markets.

Competitive Dynamics

We believe that the Recommendation mischaracterized the true manner in which competition in the Ontario capital markets really works and we feel it is important to correct this misapprehension. While the Task Force raised concerns that commercial lenders may be requiring issuers to retain the services of an affiliated investment dealer as a condition of lending, the competitive reality is quite different. As we have observed above (as well as in the CIBC Task Force Letter), clients participating in the Ontario capital markets may be able to access credit on more favourable terms by requiring participation in their credit facilities as a precondition to lender-affiliated investment dealers being considered for capital markets mandates. Sophisticated capital markets clients are well aware of this competitive dynamic and often deploy their capital markets wallet in a manner designed to reward the financial institutions who have provided the most credit or who have been willing to work with borrowers on more challenging credit requests. Lenders may decide to participate in credit facilities with lower-than-desirable returns on a credit-only basis in the hope that they will be considered for capital markets assignments to make up for the low returns on the loan. To be clear, this is **not** tied selling or the use of coercive sales practices. Calculating returns across product lines does not mean that lenders are predicating the availability of credit on the purchase of ancillary capital markets services, as clients retain the flexibility not to pursue bundling and instead seek credit and ancillary capital market services from separate providers. Instead, recognizing the bargaining power that relationship pricing provides to clients, lenders look at relationship-wide returns as part of their search for ways to lower the cost of credit to the client while forging a broader relationship across product lines. Contrary to the Task Force's conclusions on this point, calculating an institution's return across product lines is actually an example of relationship pricing at work exactly in line with applicable law and regulation, and shows the operation of the incentives to compete on price that are created by bundling.

It is worth noting that capital markets are increasingly global in nature and Canadian capital markets dealers are competing with players beyond Ontario's borders. The competitive dynamic we have described above is also present in other major financial centres. Issuers raising capital in those jurisdictions will continue to be able to leverage bundling to lower their costs. We would be very concerned about creating an unlevel playing field tilted against Ontario issuers and dealers in this regard and the potential implications for fostering capital formation in the Province. We would once again urge Staff and the Ministry of Finance to seek a broad cross section of opinion from corporate and institutional clients to test the assertion that bundling is an unwelcome form of coercive sales practices. We believe that most Ontario issuers and clients would not support proposals that would constrain their ability to strategically use their capital markets wallet to obtain better financing terms.

Independence of Bank-owned Dealers

We believe that the advice that bank-owned investment dealers provide to their clients should not be viewed as less "independent" than advice provided by other firms, even if an affiliated bank is a member of an issuer's lending syndicate. The Staff Notice references a specific recommendation of the Task Force that an independent underwriter be included in prospectus offerings if the issuer would be a "connected issuer" to one of its existing underwriters because of a commercial lending relationship. We disagree with this recommendation for several reasons.

Firstly, bank owned dealers have a strong reputation for applying market-leading due diligence and disclosure standards, including on deals where they are working with clients who borrow from their parent banks. Secondly, banks and their affiliate dealers have developed a set of robust and effective tools and policies to identify and manage potential conflicts of interest, including ethical walls, permanent information barriers and conflict management committees. These tools and policies, many of which have been vetted by regulators, are employed to ensure a separation of banks' lending activities from other capital markets activities and to ensure that confidential information regarding an issuer is not shared internally between deal teams inappropriately. Additionally, in situations where the proceeds of a securities issuance are being used to pay down a loan to a dealer's parent bank, Ontario securities law already requires disclosure in an offering document to this effect. For these reasons, the mere fact that a dealer's parent bank provides a loan to an issuer should not raise any concerns around the independence of advice nor require the participation of a dealer from outside a lending syndicate. Lastly, we are unaware of any comparable rules to the suggested changes to NI 33-105 in comparable jurisdictions, including resource-based economies like Australia or larger markets like the United States where dealers unaffiliated with commercial banks have been able to operate profitably without regulations requiring that they receive a prescribed amount of business. CIBC supports competition between investment dealers in an open market and we are concerned that any rule requiring clients to hire an investment firm on the basis of compliance with such a rule, rather than on the basis of a firm's ability to add real value for a client, will increase client costs and discourage capital formation in the Province. We note that dealers unaffiliated with lenders are well represented on various equity, debt and M&A "league tables" over the last several years suggesting that at least certain of these dealers have achieved a degree of commercial success through their business plans and execution capabilities without the need for regulatory intervention on their behalf.

As we noted in the CIBC Task Force Letter, there are many situations in which clients benefit from an integrated perspective on their needs, including advisory, underwriting and credit requirements. Such an integrated understanding of the client often leads to tangible commercial advantages for the client, including facilitating the provision of take-out loans and bridge loans that could be more challenging for lenders to provide if they do not have a clear line of sight via their affiliated investment dealer into how such loans could be refinanced in the capital markets. It is unclear to us that requiring a client to hire an investment dealer from outside the lending syndicate in this kind of scenario will always be in a client's best interest.

Such a dealer will not be able to offer the kind of integrated advice described above but a client being compelled to hire them will incur additional transaction costs.

As a final note, we are concerned that regulatory interventions which dictate that issuers must choose members of their underwriting syndicate from outside their lending syndicate will provide a systemic advantage to affiliated dealers of large global (i.e. non-Canadian) banks. These banks may not be in the lending syndicates of as many large Canadian issuers as are the Canadian banks and will therefore be less impacted by any requirements along the lines of the Recommendation. These bank-owned dealers do, however, have a recognizable brand name, deep financial resources and formidable distribution capabilities. We believe that these dealers are more likely than non-affiliated Canadian dealers to be the chief beneficiaries of the Recommendation. CIBC competes with such dealers every day and Staff will find such dealers well represented in many league tables. These dealers do not require a regulatorily-mandated allocation of a percentage of all offerings in order to compete, which is what we are concerned the Recommendation would give them.

Fostering Robust Capital Markets in Ontario

Investment dealers in Ontario today face a number of challenges which are common across the industry. Equity underwriting activity in Canada has declined for all dealers whether or not they are bank-owned.[2] As we note above, league table data conclusively demonstrates that unaffiliated dealers are quite capable of competing with bank-owned dealers. The challenges facing all players in the industry are less to do with whether a dealer has an affiliated lending business and more to do with certain macro trends, including (a) the rise of private capital, (b) the shift to index investing and (c) the decline of sectors which have historically raised significant funds in the capital markets.

In its Final Report, the Task Force noted the decline of new issuers and IPOs. We believe that the comparatively high costs and administrative burdens of being a reporting issuer relative to accessing private capital is a key force driving this decline. Global private capital assets under management (AUM) have increased by over USD$5 trillion since 2010 and increased by 950% compared to global public market capitalization growth of only 300% since 2000. The number of active private equity firms has more than doubled over the same period[3]. The competition from private capital can only be addressed by thoughtfully lowering the compliance burden of being a public company in a manner that does not sacrifice transparency and investor protection. By contrast, it is difficult to see how limiting clients' choices in how to construct an underwriting syndicate will make public markets more compelling for issuers. It is through

[2] Equity underwriting volumes in Canada have averaged $35 billion since 2017, down 29% from the 2005-2017 average (and were flat during that 12 year period).

[3] Source: McKinsey Global Private Markets Review 2020. Private capital includes buyout, venture capital, growth, private debt, real estate, and infrastructure and natural resource funds. https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review.

the narrowing of some of the disparities between the treatment of public and private companies that this particular competitive headwind should be confronted. We were very pleased to see some of the Task Force's specific proposals aimed at reducing this regulatory burden, including the introduction of a prospectus exemption for certain reporting issuers and a well-known seasoned issuer model for shelf offerings, and suggest that the pursuit of these and similar objectives is the most effective approach to ensuring a strong future for our capital markets.

Successful IPOs require a healthy ecosystem of institutional fund managers to invest. At the same time, there has been a shift away from active management to passive products (i.e. ETFs and index mutual funds), which has created fund outflows from the kinds of active stock pickers who historically have invested in IPOs. In most cases, issuers are too small to qualify for immediate inclusion in stock indices following their IPO which means their securities are not in demand from managers who are indexing. This trend is also prevalent in the U.S. markets but has been mitigated by a larger hedge fund industry which has provided a material portion of IPO capital raised. There are no easy answers to this challenge to our capital markets, but we believe rules that promote capital formation generally and provide transparency to investors around investment fees will ensure that there continues to be demand for active investment products in Ontario.

The decline in underwriting activity has been particularly pronounced in certain sectors traditionally served by unaffiliated dealers. Such dealers have historically done well serving the small cap mining, energy and technology sectors. These sectors have accounted for a smaller share of equity issuance in recent years (30% in 2012-2017 vs. 21% in 2018-2020). When we look at where IPOs are coming from in the United States we can see that many are technology and biotech companies. In Canada the technology and biotech ecosystem has been historically less than developed than in the U.S. which has resulted in fewer IPO candidates. More recently, the Canadian tech sector has incubated a large group of companies which are approaching a stage where they could be realistic IPO candidates and we are hopeful that this could result in an increase in Canadian tech IPOs. Government policies aimed at fostering and promoting innovation in the technology and biotech sectors would help this trend continue and promote both economic growth in the province as well as creating a new cohort of companies needing to access our capital markets.

Conclusion

We would like to conclude this letter by returning to the theme of the global nature of modern capital markets. All Ontario dealers, both bank-owned and unaffiliated, are competing for business with large financial institutions around the world. We are concerned that regulatory intervention that pulls Ontario out of alignment with other jurisdictions, that constrains the choices of clients and that potentially raises their costs would be antithetical to the goal of fostering capital formation in the Province. To reiterate, we do not believe that there is any evidence of illegal tied selling by banks or their affiliated dealers or that Ontario clients are less well-served in any way when they hire a bank-owned dealer. We therefore do not believe that any significant regulatory interventions of the kind contemplated by the Recommendation are advisable and could in fact hinder the ability of Ontario's capital markets to contribute to the Province's economic recovery.

Thank you in advance for your consideration on these important matters. We would be happy to further discuss any of the points raised in this submission, or more generally, on any areas pertaining to the Staff Notice.

Originally signed by

Christian Exshaw
Managing Director and Head
Global Markets
CIBC Capital Markets

Roman Dubczak
Managing Director and Head
Global Investment Banking
CIBC Capital Markets