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By Courier

Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Department of Government Services and Lands, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario
M5H 3S8

Ladies and Gentlemen:

Re: Proposed Multilateral Instrument 55-103 and Companion Policy 55-103CP - Request for Comments / Insider Reporting for Certain Derivative Transactions (Equity Monetization)

This is further to the request for comments dated February 28, 2003 by the Alberta Securities Commission on behalf of the Canadian Securities Administrators (the "CSA") in respect of Proposed Multilateral Instrument 55-103 – *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (the "Proposed Instrument") and Companion Policy 55-

103CP (the "Proposed Policy") and is submitted on behalf of Canadian Imperial Bank of Commerce and its wholly-owned subsidiary CIBC World Markets Inc. (collectively "CIBC").

1. General

The stated purpose of the Proposed Instrument is to respond to concerns that the existing insider reporting requirements may not cover certain derivative-based transactions, including equity monetization transactions which satisfy one or more of the fundamental policy rationale for insider reporting. It is believed that timely public disclosure of such transactions is necessary in order to maintain and enhance the integrity of and public confidence in the insider reporting regime in Canada. CIBC is supportive of any initiative which is intended to provide appropriate market transparency in this regard and supports the integrity of the insider reporting regime. However, we believe that the Proposed Instrument, if adopted in its current form, will in some cases capture transactions and arrangements that are not consistent with the stated purpose and may result in unnecessary, confusing or misleading disclosure. Further, we believe that some of the provisions of the Proposed Instrument are drafted such that it will be very difficult for insiders to ascertain whether certain transactions they are considering will fall within the reporting requirements of the Proposed Instrument. Our specific comments which outline these and other concerns are set forth below.

In addition, although it is likely not intended, implementation of the Proposed Rule could have the effect of imposing provincial regulatory requirements on banks and other federally regulated financial institutions. Such requirements could have an unintended disclosure impact on the business of banking, particularly routine lending activities. Accordingly, these comments are made without prejudice to our previously stated positions in this regard.

2. Specific Comments

(a) <u>Definitions of "economic exposure" and "economic interest in a security"</u> – We believe that the "economic exposure" definition is overly subjective and largely redundant as the "economic interest in a security" definition would cover substantially the same ground. In addition, we feel that the "economic exposure" definition is too broad and is not limited to dealings in securities of the reporting issuer. Examples of the types of arrangements which may be inadvertently caught by these overly vague definitions are discussed in further detail below. Although the Proposed Policy attempts to set out the justification for requiring both tests, we do not feel that any of the stated reasons are compelling. The example given of an insider entering into a "naked short" is not particularly helpful in that most insiders would be prohibited from entering into such short sales (either because of internal policies or because of governing legislation which prohibits such transactions) and, in any event, it is submitted that such a sale would likely be caught by the existing insider reporting requirements.

Further, it is not clear to us why the reporting requirement would apply to "an agreement, arrangement or understanding of any nature or kind". We believe that the reporting requirement should not be triggered until a legally enforceable agreement exists. Until such time neither party is in a position to compel performance by the other party. Requiring an insider to report an "understanding of any nature or kind" may lead to the dissemination of unreliable and misleading information. By way of example, some market participants operate their business such that the documentation for an equity monetization transaction is settled first, but not signed until an agreement is reached on the pricing and other relevant terms. Pricing may depend on the price at which the relevant participant is able (during open trading windows) to execute its hedge in respect of the transaction. This process may take several weeks or longer to complete. If the participant is not able to execute its hedge at a suitable price, the transaction may never occur. By including the words "understanding of any nature or kind" in the Proposed Instrument, one may argue that the insider should file a report at the time that the documentation is settled or when the participant begins putting its hedge in place since at either of those times one might say that they have an "understanding of any nature or kind" (i.e. the parties have an "understanding" that the transaction will move forward if the hedge is completed at a particular price and before a particular time). However, if an insider report was filed within 10 days of either of those times, the market may be mislead as to the insider's true economic position. Accordingly, we recommend that the wording of Section 2.1(a) be amended to read "enters into a binding agreement or arrangement, the effect of which is to alter …".

Similarly, we recommend that the last four lines of the definition of "economic interest in a security" be amended to read "and includes, without limitation, the extent to which such person or company has the right, directly or indirectly, to profit or share in any profit derived from a transaction in such security". We believe the other words are unnecessary and obscure the intent of the definition.

(b) <u>Section 2.2 – Exemptions</u> - The exemption noted in Section 2.2(a) refers to arrangements which do not involve, directly or indirectly, a security of the reporting issuer or a derivative, in respect of which the underlying interest is or includes as a material component a security of the reporting issuer.

First, it is not clear what type of arrangements the CSA is intending to capture by using the words “directly or indirectly” in this section. Put another way, in what circumstance could an insider enter into a transaction which would “indirectly” involve an interest in a security (except by means of a derivative, which is captured in later language). Further, although the Proposed Policy indicates that the use of the words “material component” is intended to address a situation where an insider may enter into a transaction where the underlying is a basket of securities, one of which may be a security of the reporting issuer, it may be more appropriate to move the words “is or includes as a material component” to follow the words “directly or indirectly”. By moving these words, this will assist in excluding arrangements which are not materially related to the securities of a reporting issuer, but might be said to indirectly involve such securities (some examples of which are noted below). However, it is submitted that by using the words “as a material component”, the words “directly or indirectly” could be deleted.

With regard to the “material component” test, the Proposed Policy states that in determining materiality similar considerations to those involved in the concepts of material fact and material change would apply. Presumably, this is intended to mean that a security of a reporting issuer would be considered to be a material component of a derivative entered into by an insider of the reporting issuer if a market participant would consider the presence (or level of presence) of the security underlying the derivative to be material. It is submitted that the reference to the concepts of material fact and material change in the Proposed Policy is not particularly helpful and more clarity should be built into the Proposed Instrument in this regard. For example, if an insider of a company whose securities comprised part of the S&P/TSE 60 index purchased a bank-issued deposit or entered into a third-party derivative linked to such index, at what point would the insider be required to report the transaction under the Proposed Instrument? If the insider entered into the transaction at a time when the securities were considered to be a “material component” of the derivative, what would happen if the securities became less of a component of the index (i.e. a Nortel situation)? Presumably, any new (or unwinds of) derivatives on the index would not be reported, with the result that any earlier reports may not reflect the insider’s true economic position.

Section 2.2(e) of the Proposed Instrument provides an exemption for a transfer, pledge, or encumbrance of securities by a person or company for the purpose of giving collateral for a debt made in good faith so long as there is no limitation on the recourse available against the person or company for any amount payable under the debt. While we agree with the attempt to exclude collateral arrangements from the application of the Proposed Instrument, it is not clear to us why the exemption is only applicable to full recourse debt. The Proposed Policy attempts to provide a rationale for this limitation by explaining the concern that a pledge in support of a limited recourse debt may effectively allow the insider to "put" the securities to the lender in satisfaction of the debt. Presumably, the rationale for this is a concern that in entering into a limited recourse loan, an insider would be transferring economic risk to the lender and that should be disclosed. However, it is just as likely that the insider may repay the debt with the result that any prior disclosure of the pledge will have been misleading. Requiring disclosure of a pledge in respect of non-recourse debt ignores that reality of the marketplace and it is submitted that a reasonable investor would not presume that such a pledge represents a change in an insider's economic interest in a security any more than a pledge in respect of a full recourse debt obligation. Moreover, limiting the exemption in this way effectively amends the definition of "trade" in the securities legislation which would not include a pledge (except by a control block holder) as a trade if the collateral was provided for a debt obligation made in good faith. Accordingly, if the exemption is not available for pledges in respect of limited recourse debt obligations, the CSA is presumably adopting the position that for insider reporting purposes a limited recourse loan by an insider is not considered a debt made in good faith. It is also submitted that, although the Proposed Instrument was intended to clarify the application of the insider reporting rules to certain derivative transactions, this is an example of where the broad language used in the body of the Proposed Instrument may capture other arrangements which do not fit the policy rationale. To the extent that the CSA wishes to address collateral arrangements which have the effect of divesting the insider of all of the economic risk of the underlying security, then we would recommend that specific language be included in the Proposed Instrument to this effect. However, we would submit that a blanket rejection of limited recourse debt obligations is not warranted and should be reconsidered.

(c) Section 2.3 – Existing Arrangements – We find the retroactive effect of the Proposed Instrument to be quite troubling and inappropriate. Although the Proposed Policy attempts to justify the retroactive application of the reporting requirements, we feel that its is highly unusual to have new requirements apply retroactively. Many insiders may have entered into various transactions (such as lending arrangements involving limited recourse pledges) without filing insider reports based on a reasonable expectation (and based on legal advice) that such transactions were not subject to the insider reporting requirements. Although the Proposed Policy states that it is just attempting to clarify when the insider reporting requirements will apply (since they may not have applied in the past for "technical" reasons), there will be cases where some types of transactions were clearly not caught by the previous insider reporting requirements. Accordingly, the effect of Section 2.3 will be to retroactively change the law in this area. We believe that such an action should not be taken lightly and should be reconsidered. In the event the CSA is not open to reconsidering this approach, then at a minimum we would recommend that the Proposed Policy include other examples of where the CSA has retroactively imposed regulatory requirements and state more compelling reasons why retroactive application of the requirements is necessary in this case.

3. Other Issues

As noted above, we are concerned that the broad language used in the Proposed Instrument may have the effect of requiring disclosure of transactions which do not fit the policy rationale for the Proposed Instrument and, in some cases, may result in misleading disclosure. Some such examples, as well as other related issues, are discussed below.

(a) Credit Derivatives and Similar Arrangments – Given the broad language and definitions found in the Proposed Instrument, it is arguable that the use of certain credit management techniques, including the use of credit derivatives, by an insider will result in report requirements. For example, many financial institutions use loan sales, participations and credit derivatives to help manage their credit risk to a particular sector or individual borrower. With regard to credit derivatives, this could be accomplished by having the financial institution enter into a credit default swap with a third party such that the financial institution will in effect be reimbursed by the third party if the borrower defaults in its obligations to the financial institution. With regard to loan sales and participations, this may be accomplished by the financial institutions simply "selling off" a portion of the loan to a third party. In each case, if the financial institution was an insider of the relevant borrower/reporting issuer at the time the loan sale, participation or credit derivative was entered into, and the obligation of the borrower was represented by some type of bond, note or other evidence of indebtedness, it could be argued that by reducing its exposure the financial institution had entered into an arrangement which changed its economic exposure to a reporting issuer and that the transaction involved a security of the reporting issuer. Presumably, the same result would follow had the financial institution simply entered into a loan with a reporting issuer in circumstances where the financial institution was an insider of the reporting issuer and the loan was evidenced by some type of security, but not if the loan was not evidenced by a security. This appears to be a very curious result.

Further, given the nature of an ongoing lending relationship, one could imagine many situations where a lender might have "understandings or arrangements" with a reporting issuer borrower which could alter the lender's "economic exposure" to such borrower. For example, each time the borrower makes a scheduled payment on the loan, the financial institution's economic exposure to the borrower will have changed and, it could be argued, that the arrangement does not fit within the exemption in Section 2.2(a) of the Proposed Instrument because the payment may directly or indirectly involve a security (i.e. bond, debenture or other evidence of indebtedness) of the borrower. Again, it is submitted that requiring such disclosure will not further the stated policy objectives of the Proposed Instrument and suitable exemptions should be considered.

(b) Reporting Issuer as Insider – As noted above, a reporting issuer may be considered an insider of itself in circumstances where the reporting issuer has purchased, redeemed or otherwise acquired any of its securities for so long as it holds any of its securities. If, for example, a reporting issuer is in the process of redeeming some of its securities or is engaged in a normal course issuer bid, there may be a time period during which it is an insider of itself. During this time period, it is conceivable that the reporting issuer could be involved in various transactions which could be construed as altering the reporting issuer's economic exposure to itself or its economic interest in it securities. For example, there may be situations when the reporting issuer is holding its own securities as collateral for a loan to one of its employees. Indeed, most Canadian financial institutions are permitted under their governing legislation to hold their own securities as collateral up to a certain regulated limit. In the event the financial institution is in the midst of a normal course issuer bid, holds its own securities as collateral for a loan and realizes on such collateral because of a borrower default, should the financial institution file an insider report with respect to the securities it realized upon? What about securities previously held as collateral? It is submitted that such disclosure serves no useful purpose and the CSA should consider amending the Proposed Instrument to narrow the focus of the reporting requirements.

(c) Insurance Contracts and Deposits – By virtue of the definition of "securities" found in relevant securities legislation, certain insurance contracts and deposits issued by banks, credit unions or loan and trust companies are excluded from the application of such legislation. However, one effect of the Proposed Instrument will be to cause such instruments to be subject to the new insider reporting regime. For example, if an insider of a reporting issuer insurance company purchases an insurance contract which pays a yield linked to an index which includes as a material component a security of the insurance company, then the insider should presumably be reporting the purchase of the insurance contract under the Proposed Instrument. As with the retroactive effect of the Proposed Instrument noted above, it is submitted that careful consideration should be made before making such a substantial change to one of the primary assumptions underlying Canadian securities law.

(d) Insider Report Form – Although it is not the purpose of this comment letter to respond to issues which might relate to the recently released amendments to Mulitlateral Instrument 55-102, we believe that the situations noted above and the attempts to fit them within the framework of a regime intended largely for another purpose will be highlighted by practical difficulties associated with reporting on the current insider form. In this regard, we suggest that the CSA not introduce such a broad and sweeping change to the insider reporting obligations without at the same time carefully considering the reporting methodology. Special consideration should be made as to whether the current reporting form is sufficiently flexible to allow an insider to accurately complete the report in all of the circumstances now contemplated by the Proposed Instrument and whether such form will be an effective means of communicating to the market what action the insider has taken and how the particular action will change the insider's "economic exposure" to a reporting issuer or "economic interest in a security". On the latter point, given that many insiders may enter into equity monetizations, but still retain voting rights and certain upside and downside exposure to the securities being monetized, or even cash-settle the monetization and thereby retain full economic interest in the securities, we would be concerned that certain disclosure, if not clarified by means of a specialized form (or even a separate form), may result in confusing and misleading disclosure. We would also submit that the CSA may wish to consider the US approach to reporting such transactions.

CIBC appreciates that opportunity to provide this submission to the CSA on this very important issue. We would be happy of expand upon that matters addressed if you so require. In addition, since CIBC (and certain of its affiliates) is active in equity monetization and derivatives business, we would be happy to meet or provide any other information which might be of assistance to the CSA in its consideration of this matter.

Yours very truly,

Clint A. Calder
Assistant General Counsel

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