



February 18, 2022

VIA EMAIL

Ontario Ministry of Finance
95 Grosvenor Street
Toronto, Ontario M7A 178
CMA.Consultation@ontario.ca

Dear Sirs / Mesdames:

Re: Consultation – Capital Markets Act (the CMA) – Statutory Civil Liability in Connection with the Distribution of Exchange-Traded Funds

The Canadian ETF Association (**CETFA**) welcomes the opportunity to provide feedback on the Capital Markets Act – Consultation Commentary published by the Ministry of Finance in October 2021 (the **CMA Consultation Paper**) specifically as it relates to statutory civil liability in connection with the distribution of exchange-traded funds (**ETFs**).

CETFA is the only ETF association in Canada and represents members comprising 95% of the ETF assets under management in Canada. The mandate of CETFA is to support the growth, sustainability and integrity of Canada’s ETF industry on behalf of our members, who are typically ETF managers.

CETFA is taking this opportunity to provide feedback on the discussion in Part 4 of the CMA Consultation Paper, specifically on the appropriateness of deeming that all persons or companies who purchase ETF securities on an exchange have secondary market civil liability rights.

CETFA acknowledges the uncertain state of the statutory rights of action that are currently provided under securities legislation in Ontario to ETF investors purchasing ETF securities on an exchange. This uncertainty has been highlighted in recent case law at the Ontario Superior Court¹ and Court of Appeal² in *Wright v. Horizons ETFs Management (Canada) Inc.* CETFA agrees with the statements by Justice Perell in his recent decision³ that the hybrid regulation of ETFs under both Part XXIII of the *Securities Act* (Ontario) (the **OSA**), which provides a statutory cause of action for misrepresentations in a prospectus for distributions in the primary market (the **Primary Market Civil Liability Regime**), and Part XXIII.1 of the OSA, which provides a statutory cause of action for misrepresentations for purchasers who acquire securities in the secondary market (the **Secondary Market Civil Liability Regime**), places “the distribution of ETFs in a problematic and uncertain state” that “may require legislative initiative to resolve”.⁴ CETFA supports legislative intervention under the CMA to provide persons who purchase ETF securities on an exchange with secondary market civil liability rights as are currently set out under the Secondary Market Civil Liability Regime in the OSA.

¹ *Wright v. Horizons ETFs Management (Canada) Inc.*, 2019 ONSC 3827; *Wright v. Horizons ETFs Management (Canada) Inc.*, 2021 ONSC 3120.

² *Wright v. Horizons ETFs Management (Canada) Inc.*, 2020 ONCA 337.

³ *Wright v. Horizons ETFs Management (Canada) Inc.*, 2021 ONSC 3120.

⁴ *Wright v. Horizons ETFs Management (Canada) Inc.*, 2021 ONSC 3120, para. 156.

Secondary market civil liability rights are appropriate for an ETF investor who purchases their securities on an exchange as such investor's experience purchasing ETF securities bears strong hallmarks of secondary market, rather than primary market, activity in the following important ways:

- ETF securities trade on an exchange. Purchasers of ETF securities purchase ETF securities from a seller who has made them available over the exchange, as opposed to directly from the issuer of those securities.
- These investors do not transact with the issuer directly in making their purchases. The designated brokers and dealers who have entered into agreements with the issuer are the only entities that purchase from the issuer directly.
- The purchase price for ETF securities is paid to the person who sold those securities, rather than to the issuer of those securities.
- The sale and purchase prices are dictated by the secondary market trading prices. ETF securities do not trade at net asset value on the exchange.
- The buying and selling of ETF securities on an exchange is similar to the buying and selling of shares of a typical corporate (non-investment fund) issuer on the exchange.
- The typical source of liquidity for these investors is through trading on the exchange.

The Secondary Market Civil Liability Regime was specifically designed to regulate trades that operate in the manner described above. Importantly, under this regime, damages are assessed based on the difference between the trading price paid for the securities and the trading price received upon the disposition of those securities (or if the securities have not been disposed of, the trading price of the issuer's securities on the securities' principal market). Because ETF securityholders who have purchased or sold their securities on an exchange only interact at trading price, this regime and the mechanism detailed within the regime to assess damages is wholly appropriate for trades in ETF securities.

To quote Justice Perell in furtherance of this point:

“From a policy perspective it would be odd and inconsistent with the overall balanced design of the Act to treat the trading of ETFs, which are so closely associated with the secondary market, as outside the operation of Part XXIII.1 and within the operation of Part XXIII.”⁵

The only complicating factor to the treatment of ETF securities trades as solely secondary market activities is that authorized dealers who participate in selling ETF securities on the exchange may have subscribed for such securities from the manager of the ETF, who will issue new ETF securities (referred to as **Creation Units**). Securities regulators have taken the view that a distribution of a Creation Unit is considered to be a primary market distribution, and the Court of Appeal supported the position that “Creation Units are considered by the *Securities Act* to be primary market units and owners of those units should be entitled to invoke their rights thereunder”⁶ pursuant to the Primary Market Civil Liability Regime in Part XXIII of the OSA.

It is an operational reality that following issuance, Creation Units are combined in a dealer's inventory with other ETF securities prior to being sold on the exchange, and an ETF purchaser cannot know whether his or her purchase involves a purchase of Creation Units or a resale of ETF securities in the secondary market. This leaves ETF investors in an uncertain and seemingly irreconcilable position of not being able to

⁵ *Wright v. Horizons ETFS Management (Canada) Inc.*, 2019 ONSC 3827, para. 122.

⁶ *Wright v. Horizons ETFS Management (Canada) Inc.*, 2020 ONCA 337, para. 143.

determine if, following the Court of Appeal's decision, it should bring a claim under the Primary Market Civil Liability Regime or the Secondary Market Civil Liability Regime.

As noted above, an ETF investor's experience in trading in ETF securities is consistent with a secondary market activity and would be treated as such for the purposes of the Secondary Market Civil Liability Regime but for the position taken with respect to Creation Units. A practical solution to this complication is to deem that all persons or companies who purchase ETF securities on an exchange have secondary market civil liability rights. This removes the issue of having to resolve the question of whether Creation Units were or were not purchased by the investor and puts all ETF investors who purchase ETF securities on an exchange on equal footing to pursue causes of action for misrepresentations.

Thank you for this opportunity to express our comments about the CMA Consultation Paper.

If you have any questions or if we can be of any other assistance, please do not hesitate to contact Pat Dunwoody, Executive Director of the CETFA, at (647) 256-6637 or at patdunwoody@cetfa.ca.

Yours truly,

CANADIAN ETF ASSOCIATION

By: (signed) "Pat Dunwoody"

Pat Dunwoody

Executive Director