Canadian ETF Association

July 06, 2022

Via E-mail - IOSCO-ETF-consultation@iosco.org

Damien Shanahan and Thomas Willman
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

Dear Sirs:

Re: ***Exchange Traded Funds – Good Practices for Consideration***

This letter is submitted on behalf of the Canadian Exchange-Traded Fund Association ("CETFA"), which is based in Toronto, Canada. CETFA is the sole exchange-traded fund ("ETF") association in Canada and represents Canadian ETF providers accounting for approximately 96% of all assets under management of Canadian ETFs as of June 30, 2022.

One of CETFA's primary goals is to deal with policy or regulatory issues that impact Canadian listed ETFs, our member firms and their investors. Accordingly, CETFA appreciates the opportunity to provide comments on the IOSCO Good Practices for Consideration.

Attached as Schedule A are our responses to the questions raised in your Consultation Report dealing with *Exchange Traded Funds – Good Practices for Consideration*.

Thank you for giving us this opportunity to comment on this Consultation Report. We welcome any further discussions regarding this initiative.

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Schedule A

CETFA Responses – IOSCO – Consultation Paper - ETF – Good Practices for Consideration

Below is a summary of the Measures notes in the IOSCO Consultation Report and the CETFA's responses to the Questions in the Report.

Measure #	Measure
	Effective Product Structuring
1	Regulators and responsible entities are encouraged to consider the range of asset classes and investment strategies that may be appropriate for the ETF structure, taking into account their nature, novelty, and complexity, the effectiveness of the arbitrage mechanism for such assets and strategies and local circumstances.
2	Regulators are encouraged to consider requirements regarding the transparency of an ETF's portfolio and/or other appropriate information provided to market participants so as to facilitate effective arbitrage.
3	For jurisdictions that mandate the provision of iNAV, regulators and/or trading venues are encouraged to consider means to enhance the accuracy and usefulness of iNAV.
4	Responsible entities are encouraged to: (i) conduct due diligence on APs and MMs when onboarding them to the ETF, with a view towards having those that are capable of facilitating an effective arbitrage mechanism and providing liquidity; (ii) conduct ongoing monitoring on APs and MMs for the ETF regarding, amongst others, the functioning of the arbitrage mechanism and liquidity provision; and (iii) avoid exclusive arrangements with APs and MMs if they may unduly affect the effectiveness of the arbitrage mechanism.
5	Responsible entities are encouraged to put in place appropriate arrangements to facilitate an effective arbitrage mechanism, including contingency plans to address the circumstances where the arbitrage mechanism of the ETF is impaired.
6	Regulators are encouraged to consider whether the securities laws and applicable rules of securities exchanges within their remit and jurisdictions appropriately address potential conflicts of interests raised by ETFs.

	Disclosure
7	For ETFs, in particular those that invest in more complex or novel asset classes, or use more complex investment strategies, regulators are encouraged to consider appropriate requirements for the adequacy and appropriateness of the disclosures regarding ETF-specific aspects, including whether certain disclosures are presented in an understandable manner and whether they address the nature of risks associated with the ETFs' strategies.
8	Regulators are encouraged to consider appropriate requirements for the disclosures of fees and expenses for investing in ETFs (including secondary market trading costs) in a way that allows investors to make informed decisions about whether they wish to invest in an ETF and thereby accept a particular level of costs.
9	Regulators and responsible entities are encouraged to consider appropriate disclosure requirements or disclosures to help investors to clearly differentiate ETFs from other ETPs / CIS, as well as appropriate disclosures for index-based and non-index-based ETFs.
	Liquidity Provision
10	Regulators and/or trading venues, where applicable, are encouraged to monitor secondary market trading and market making activities of ETFs and have rules governing the orderly trading of ETF shares.
	Volatility Control Mechanisms
11	Regulators and/or trading venues, where applicable, are encouraged to appropriately calibrate volatility control mechanisms applicable to ETFs, considering factors including their liquidity profile and volatility profile. Where an ETF is listed or traded on a number of trading venues, those trading venues are encouraged to consider communicating with one another as appropriate when VCMs are triggered.

Measure #	Question #	Question	Responses – CEFTA
		Effective Product Structuring	
1	1	What additional considerations do regulators or responsible entities consider in determining the range of assets and strategies to be invested or implemented by an ETF and how are they different from those concerning OEFs?	• The ability of the underlying securities to be traded and valued using widely available and independent pricing sources. • Lack of industry standards (e.g., Committee on Uniform Securities Identification Procedures (CUSIP), International Securities Identification Number (ISIN), Stock Exchange Daily Official List (SEDOL)) for security identifiers relating to options, futures, swaps, etc. making it difficult for standardized baskets and pricing. • The ability for authorized participants (each an AP) and market makers (each a MM) to properly price the exchange traded fund (ETF) and hedge the underlying or the ETF itself. • The likelihood that APs and market makers are able to value the ETF at close to the ETF's net asset value (NAV) considering the underlying securities of the ETF. • When assessing new products part of the development process includes working with the MM to assess bid ask spread expectations. • The need for performance fees needs to be called into question.
1	2	What other good practices have been put in place to take into account the target investors at product design phase?	• Risk rating of an ETF is also calculated as per regulatory requirements. This would provide one possible data point to assess investor fit. • In addition, in a more broad sense, distribution strategies are evaluated to determine what channels of investors would be targeted based on the characteristics of the product. • Use of proxy securities to hedge against the ETF, reducing borrowing costs and risk thus tightening of the bid/ask spread.

Measure #	Question #	Question	Responses – CEFTA
			• Determining the suitability of the product for multiple distribution channels (i.e., exchanges and platform traded funds).
2	3	Do the merits and other considerations as set out above accurately reflect the issues for different portfolio and basket information disclosure approaches?	• Yes. • Providing transparency to non-market participants (i.e., end investors) more frequent than outlined in the regs may be useful to some investors. However, most investors will not have the ability to utilize this information. • If the Canadian securities regulators determine that more transparency would be useful to investors, then it may also be worthwhile to extend such requirements to open-end funds (OEFs).
2	4	Other than the examples of portfolio and basket information disclosure approaches as listed above, are there any additional portfolio-related disclosure that have been used to support the functioning of the ETF arbitrage mechanism?	• There are sponsors which provide intra-day trading information (for active ETFs) to the AP/MM to allow for continuous effective arbitrage. • Futures and swap pricing spreadsheets. • Performance fee information.
3	5	What additional means or disclosures have been put in place to address issues relating to iNAV?	• The Canadian market does not require iNAV calculations. • iNAV is problematic in that unless the underlying securities are trading on recognized exchanges in the time zone aligned with the underlying securities and ETF it is not a reliable tool. • Once fixed income, derivatives and non-NA equities are introduced fair value is the only way to produce an iNAV and it becomes difficult and costly to perform.

Measure #	Question #	Question	Responses – CEFTA
			Further, introducing fair value pricing creates a host of estimates, further limiting the value of iNAVs on these products to investors. • In Canada, APs and MMs so far have done a good job of pricing ETFs in the market with fairly narrow spreads even during volatile markets and accounting for unique underlying securities.
4	6	Have the examples of considerations above captured the key considerations relating to selection and due diligence of APs, and where relevant, MMs, by responsible entities?	• Yes, but in a market such as Canada where there are a limited number of financial institutions that have the ability to be an AP (e.g., big 6 Canadian banks) there is no real need for looking at regulatory history or reputation since these firms are highly regulated entities. Also, the number of MMs is limited in our market place. • They should also consider: o Their ability to make markets for an ETF based on the underlying taking into account such things as: > Ability to deliver in kind specific to global markets; > Size of their fixed income desk and inventory; > Ability to use proxies; and > Specific ability in new assets such as cryptocurrency.
4	7	Do you agree with the proposed good practice to promote competition in ETF arbitrage and market making? Are there any justifiable circumstances where exclusive	• Agree with the proposed good practices • However, having multiple APs step in would be infeasible in a market the size of Canada's there are a limited number of financial institutions that have the ability to be an AP (e.g., big 6 Canadian banks).

Measure #	Question #	Question	Responses – CEFTA
		arrangements with APs or MMs would bring net benefit ETF investors as a whole?	• Only circumstances where an exclusive arrangement would benefit ETF investors is the ability to do deliver global market securities in kind, fixed income in kind or other hard to source assets such as crypto/digital assets. • Having exclusive arrangements with an AP or MM is never in the best interest of ETF investors. Price competition is necessary to ensure the arbitrage mechanism is producing the tightest of available spreads. The issue in Canada is that with a limited number of financial institutions that have the ability to be an AP have, in some cases, different abilities to deliver global securities or crypto/digital assets, creating inefficiencies for the ETF, and ETF investors.
5	8	Do you agree with the proposed good practices and jurisdictional examples as set out above? What additional good practices related to primary market arrangements have been put in place to promote effective arbitrage?	• Agree. • No additional comments.
5	9	To what extent should responsible entities be encouraged to provide more frequent disclosure of portfolio information to the public to facilitate the arbitrage mechanism? Does it depend on the information APs/MMs receive on a daily basis and the ETF’s arrangements with APs/MMs?	• If full disclosure is given to APs/MM then they should be able to effectively mitigate any arbitrage opportunities. As a result, although disclosing such information to the public, may have value, it may not be necessary from an arbitrage perspective.

Measure #	Question #	Question	Responses – CEFTA
5	10	Have the examples above captured the key operational risks that may lead to disruption in achieving the ETF's investment objective? What additional good practices have been put in place to mitigate such risk?	• No comment.
6	11	Do you agree that the examples above are the key considerations related to potential conflicts of interest? In addition to the above, are there any other potential conflicts of interests associated with ETFs that warrant careful considerations?	• Making sure all unitholders are fairly treated in Funds that offer OEF series and ETF series maybe something to be considered.
6	12	What additional good practices have been put in place to help mitigate conflict of interests between the ETF manager and other stakeholders?	• Securities regulators in Canada have mandated that each ETF have an independent review committee (an IRC) to deal with conflicts of interest.
		Disclosure	
7	13	What additional good practices in disclosure have been put in place to help investors better understand (i) the risks and	• Not specific to ETFs but the cost of ownership being considered would be a good practice so investors truly understand what it costs to own an ETF or an OEF.

Measure #	Question #	Question	Responses – CEFTA
		vulnerabilities of an ETF's arbitrage mechanism; and (ii) the specificities of ETF investment strategies?	
8	14	Have the examples above captured the fees and costs associated with ETFs that are important considerations to investors?	• Since a total expense ratio (TER) is currently not well understood in Canada, a ratio combining a management expense ratio (MER) and a TER should be adopted since a synthetic ETF could have a very low MER but a very high TER with the swap fee embedded in the swap and investors would not be necessarily aware. If you combined the two ratios, you could identify a synthetic ETF as not being as cost effective anon-synthetic ETF.
8	15	What additional good practices in disclosure have been put in place to help investors better understand their cost of investing in the ETF?	• In Canada, the ETF market is regulated by provincial securities commissions. Since December 10, 2018, dealers have been required to send ETF Facts to investors no later than the second business day following a purchase of ETF securities. "The ETF Facts is a two-page document that summarizes key information about an ETF in a simple, accessible and easily comparable format. It is designed to help you make an informed decision about your investment by including information such as a fund's investments, risk rating, past performance and the costs associated with owning it. Importantly the ETF fact sheet also outlines to investors the ETFs Average bid-ask spread (C$) to help with their investment decision.
9	16	What additional good practices in disclosure have been put in place to help investors differentiate (i) ETFs from other ETPs / CIS; and (ii)	• Every ETF has a semi-annual Management Report of Fund Performance produced that provides investors with a discussion of fund performance and is an analysis and explanation that is designed to complement and supplement an investment fund's financial statements.

Measure #	Question #	Question	Responses – CEFTA
		conventional ETFs from other more complex ETFs?	• Canada needs a much better identification process for ETFs either through short name or ticker to identify passive vs. active, leveraged/inverse, commodity, crypto, hedged vs. unhedged.
		Liquidity Provisions	
10	17	Please describe how ETFs' trading or market making activity is monitored by regulators and trading venues. Does monitoring enhance the secondary market liquidity of ETFs? What are the key metrics that should be monitored and what are the appropriate follow-up actions?	• A 5 minute trading halt occurs in Canada across all venues if the price of a stock moves 10% or more from 9:50 am (EST) to 3:30 pm (EST). In the first 20 minutes from 9:30 am (EST) to 9:50 am (EST) a 20% price move will trigger a circuit breaker. The measurement is not compared to NAV like some other markets. • The Toronto Stock Exchange (the TSX) has in addition to those established by the Investment Industry Regulatory Organization of Canada (IIROC), established its own market place thresholds for each ETF that trades on the TSX (i.e., the metrics are calculated annually based on an ETF's liquidity, its volatility and factors relating to its underlying portfolio) and shared with ETF providers and MM for additional input (e.g., whereas IIROC typically mandates a 10% threshold for ETFs, the TSX usually uses a 5% or lower threshold). • On each trading day, the TSX starts with a reference price for each ETF that is created by taking a random snapshot at the mid-point in the last minute of trading on the previous trading day. That reference price is then used to calculate the threshold price for the opening trades on the current trading day which has a buffer of an additional 20% built-in. After opening, the price of each ETF that trades on the TSX reverts back to the standard threshold for the balance of that trading day. In the pre-open, the TSX also monitors and actively reaches out to MMs to ensure that the pricing of all ETFs that trade on the TSX are in-line.

Measure #	Question #	Question	Responses – CEFTA
			• The TSX also publicly publishes these threshold percentages and has encouraged other Canadian marketplaces to use them for trading on their venues. • A bid/ask spread should be considered and each type of ETF could have a defined parameter based on its underlying securities. • Stress testing should also be considered.
10	18	What rules are there to govern the cessation of liquidity provision by a MM? Do they minimize the impact to the secondary market liquidity of an ETF? What additional good practices have you considered in this regard?	• Although not currently permitted, having more than one MM may be helpful in certain situations.
		Volatility Control Mechanisms	
11	19	What are the key parameters that regulators and/or trading venues should take into account in calibrating the format of VCMs and the relevant thresholds applicable to different types of ETFs?	• Looking at underlying investments and their volatility and use that as a proxy to monitor the ETFs volatility and use that as a trigger for halts.
11	20	What additional good practices related to design or implementation of VCMs have been put in place?	• No comment.