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Re: Enhancing Exchange-Traded Fund Regulation

FAIR Canada is pleased to provide comments in response to the CSA Consultation Paper 81-409: *Enhancing Exchange-Traded Fund Regulation* (Consultation).

FAIR Canada is a national, independent, non-profit organization known for balanced and thoughtful commentary on public policy matters. Our work includes advancing the rights of investors and financial consumers in Canada through:

- Informed policy submissions to governments and regulators
- Relevant research focused on retail investors
- Public outreach, collaboration, and education
- Proactive identification of emerging issues.¹

A. Introduction

We support the CSA's review to assess whether existing regulations for ETFs remain appropriate given market changes and developments, and the need to address potential gaps and enhancements. We also support the CSA objective of promoting fairness in ETF trading and increasing transparency and efficiencies that benefit investors in the primary and secondary markets.

¹ Visit www.faircanada.ca for more information.

Our submission responds to the questions and issues directly affecting retail investors, particularly regarding the proposed new disclosures and offering an exchange-traded series together with an unlisted series.

B. Proposed New Disclosures for Investors

We have organized our comments under this heading as follows:

- General Comments (which apply to all proposed new disclosures listed below)
- Policies and Procedures for Creations and Redemptions of Units (Consultation Topic III.A.)
- Secondary Market Trading (Consultation Topic III.B.)
- Authorized Participant (AP) Arrangements (Consultation Topic III.C.)

General Comments

We support the CSA's efforts to enhance disclosures to promote a more efficient arbitrage mechanism. Greater public transparency serves the interests of all ETF investors.

While institutional or highly sophisticated investors may most readily understand the CSA's proposed new disclosures, we recognize that increased transparency benefits all market participants. Enhanced disclosure can improve overall market functioning, reduce pricing inefficiencies, and support investor protection, even for retail investors who may not fully understand the technical details.

However, to ensure disclosures are as helpful as possible for retail investors, we recommend:

- **Use plain language:** Explain technical concepts simply, avoiding jargon wherever possible. For example, describe the arbitrage mechanism as "the process that helps keep ETF prices in line with the investments they hold."
- **Behavioural testing:** Develop and test new disclosure designs with real investors to ensure usability and comprehension. Identify barriers to understanding and address them through improved design and education.
- **Layered disclosure:** Present information in a format that is easy to read on any device, using visual aids and "What does this mean for you?" sections to provide context.
- **Standardized formats:** Require ETF disclosures to follow a prescribed format, making it easier for investors to compare products.

Simply stated, many retail investors will need additional education, support, context, and simplification to understand the proposed disclosures. All public disclosures for investors should follow this approach, as it reduces the cognitive burden on retail investors and helps improve their understanding and ability to make informed choices.

Policies and Procedures for Creations and Redemptions of Units

While we recognize that retail investors do not directly participate in the primary market, we support the proposal to require ETFs to implement robust policies and procedures for the creation and redemption of units, as well as the development of a Companion Policy to outline their content. The operation of creation and redemption mechanisms, along with AP arrangements, can significantly impact secondary market liquidity, pricing, and investor outcomes. For this reason, clear policies and disclosures about these mechanisms, even if technical, can indirectly benefit retail investors by promoting efficient market functioning and fair pricing.

To better support retail investors, we also recommend that prospectuses include high-level explanations of any elements that materially affect investor outcomes, such as:

- Having only one AP or an exclusive arrangement
- Potential conflicts of interest between ETF managers and AP(s), including incentives or rebates offered to APs
- Transaction costs associated with creations and redemptions that are indirectly passed on to investors

To maximize visibility, consider incorporating these disclosures into ETF Facts, using clear and concise language, along with visual summaries.

Secondary Market Trading

1. Website Disclosure of Metrics

While the proposed disclosures aim to improve transparency and decision-making, we believe the average retail investor will face several challenges in understanding and using information such as net asset value per security, closing price, premium or discount to net asset value (NAV), and bid-ask spread effectively.

This stems in part from the complexity of the financial terminology. For example, terms like NAV, bid-ask spreads, and premium/discount are technical terms that may not be familiar to many retail investors. We also note that metrics such as “median bid-ask spread over 30-days” or “percentages of trading days at a premium/discount” require a level of financial literacy and data skill that many retail investors may not possess. Without providing additional context, the raw data would be difficult to interpret, potentially leading to information overload.

To ensure the proposed disclosures are meaningful and accessible to retail investors, we believe the CSA should consider the following:

- **Plain Language Summaries:** include clear and easy-to-understand explanations alongside the different metrics, and require expandable sections on the ETF's website to encourage better explanations about the relevance of such data

- **Educational Resources:** Require ETFs' websites to include short videos, FAQs or interactive guides explaining ETF pricing, arbitrage, and trading costs, or links to investor education portals that offer deeper learning for those interested.
- **Standardized Presentation and Layout:** Consider mandating a uniform layout and terminology across ETF websites to facilitate comparison, reduce confusion, and ensure disclosures are mobile-friendly and accessible to users with disabilities.

Finally, to ensure such disclosure is as accessible as possible, ETF Facts should include a direct link to the specific webpage with this information, not just the general website.

2. Monitoring of Arbitrage and Liquidity Provision

We support the proposal to require ETF managers to:

- Monitor the functioning of the arbitrage mechanism and liquidity provision on the secondary market
- Establish, maintain, and follow policies and procedures for their monitoring to ensure consistent monitoring and oversight of the functioning of arbitrage and liquidity

In response to Consultation Question #13, while disclosing the ETF manager's parameters on the ETF's website can help promote transparency and market integrity, retail investors are unlikely to understand its significance without a clear and straightforward explanation. In this context, the recommendations made under subheading "1. Website Disclosure of Metrics" above are equally applicable.

To the extent that the ETF manager discloses its parameters, the CSA should also consider whether the ETF manager should explain how these thresholds were reached, what happens when the thresholds are breached, and any historical data on past breaches.

Authorized Participant (AP) Arrangements

1. Disclosure of AP Arrangements

We believe information regarding an ETF's arrangements with its AP is important for an investor's evaluation of an ETF. While the CSA proposes that AP agreements be filed with the prospectus as "Material Contracts," we recommend that the CSA consider requiring summary information about these agreements to be included in the ETF Facts or the ETF's website. This would enhance visibility and accessibility for retail investors beyond the current proposal.

2. Minimum Number of APs

We support the CSA's consideration of requiring ETFs to contract with at least two APs to mitigate concentration risk and promote competitive arbitrage. The presence of multiple APs helps ensure

a more resilient and efficient primary market, particularly during periods of market stress when liquidity can deteriorate. Relying on a single AP also exposes investors to the risk of impaired arbitrage and wider bid-ask spreads, which can result in ETFs trading at prices that diverge significantly from their NAV, undermining investor confidence and fairness.

However, we recognize that onboarding multiple APs may pose challenges, particularly for newly launched or niche ETFs. Where an ETF contracts only one AP due to legitimate constraints, we recommend that the CSA prohibit the use of exclusive arrangements to ensure that additional APs can be added when feasible. This approach would preserve flexibility for ETF innovation while maintaining safeguards against undue reliance on a single liquidity provider.

Furthermore, FAIR Canada supports the proposal to disclose the identity of the sole AP in the ETF's prospectus and ETF Facts document. Such transparency is critical for retail investors to understand the structural risks associated with their investments. However, many retail investors will likely not understand the implications of an ETF having only one AP unless the ETF's disclosure includes an easy-to-understand explanation of how the arbitrage market works and the risks of an ETF having only one AP.

Lastly, an ETF with only one AP should have a clear, plain-language risk warning. We recommend that the CSA test the risk warning with retail investors and prescribe its form to promote understanding.

C. Offering an Exchange-Traded Series Together with Unlisted Series

Based on the concerns and issues identified in the Consultation, we recommend prohibiting switches between exchange-traded series units and unlisted series units. In this regard, we note that most fund managers already prohibit switches between exchange-traded and unlisted series because of the distinct liquidity preferences of each investor group. Allowing switches could undermine these preferences and introduce unintended arbitrage opportunities. We also believe that prohibiting switches would address concerns about cost allocation and fairness.

D. Conclusion

We commend the CSA for working to make ETF trading fair, transparent, and efficient for investors in both the primary and secondary markets.

As the CSA advances its proposals for new disclosures, it is important that these are designed and tested to ensure retail investors understand and can act on the information. We encourage the CSA to continue to collaborate with investor advocates, industry participants, and behavioural scientists to develop clear, comparable, and accessible disclosures across all platforms and devices. Through ongoing collaboration and a commitment to clear, accessible disclosures, the CSA can help ensure that transparency delivers real value to investors across the market.

Thank you for considering our comments on this critical issue. As investor advocates, we appreciate the opportunity to share our perspective and help shape policies that put investors first. We welcome ongoing dialogue and collaboration with the CSA and other stakeholders to build fair, transparent, efficient, and resilient capital markets for all Canadians. If you would like to discuss our submission further, please reach out—we are committed to working together to support better outcomes for investors.

Sincerely,



Jean-Paul Bureaud
President, CEO and Executive Director
FAIR Canada | Canadian Foundation for the Advancement of Investor Rights