

Structured Notes Roundtable Report

May 2006

Investors have not always been well served by innovations in the financial services industry. Consider a time not long ago when advisors were inundated with launch after launch of a new fund dedicated to some hot asset category. Those launches rode up along with the stocks they invested in, until they crested—then dropped precipitously—and most of those funds have since been terminated or merged into more diversified portfolios.

What's hot now? Well, there's hardly a week without a new principal-protected note (PPN) rolled out to advisors for their clients. It seems an odd phenomenon. Principal protection? Why now, in a market, that at least for Canadians, has been rising? To be sure, a lot of investors retain painful memories of being scorched in the tech bubble. Can that bonfire of the assets be avoided in the future? Well, PPNs may be one answer. Still, there's more here than meets the eye — or gets presented in the business pages of the mainstream media. These products are not necessarily trying to ride a wave of rising asset values; instead they're trying to lock in stock appreciation, while protecting against the downside. But, can PPNs meet this promise? They are an evolution from the index-linked GICs the banks pioneered in the mid-1990s, as declining interest rates took the oomph out of the high-yielding GICs of the late 1980s and early 1990s that many investors had relied on. That said, PPNs are not quite fixed-rate yield products. In some cases, there's a regular interest payment, just like a bond, along with capital protection, unlike a bond. In other cases, the financial engineering behind the product allows for a return that could be better than the underlying index or mutual



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François Héroux
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Luke Seabrook
BMO Nesbitt Burns

fund portfolio; or worse. Or it could allow access to new asset classes.

So where do these new products — which have attracted considerable investment dollars — fit within traditional portfolios? How do they work and how much do advisors need to know about the complex engineering behind what is ultimately a bank-guaranteed deposit with variable interest rate? To be sure, some advisors are more confident than others about the reliability of these products. But all want to know more about how they work, and the chief question: what's the downside?

We've seen three years of great performance in the Canadian market. What's the appeal for principal-protected products now? And is it supply- or demand-driven?

Nicolas Patard, Managing Director, Global Equity Derivatives, National Bank Financial Group: Why now? The investment crowd that were overall risk takers over the past 20 years has grown older. They've suffered very recently through serious market drawdowns. You have a crowd of investors that want to sleep well at night and know that, facing retirement — a time of their life when they're going to need the money that they've earned and put aside — they want to know that it's not going to shrink but will remain there for the years to come.

Luke Seabrook, Executive Managing Director, Financial Products, BMO Nesbitt Burns: I think part of it is a low-interest rate environment. Where your opportunity cost is 2% or 3% per annum, you're obviously willing to look for alternative forms of returns.

Jeffrey O'Brien, President and CEO, ONE Financial Corporation: I would add that there have been a lot of advances in financial engineering that have brought forth a number of different structures offering unique benefits that previously weren't available. Besides investors who are looking to find a way to earn better returns on their GIC investments or to pursue equity returns with the comfort of principal guarantee, some of these structures, like the CPPI structure, give investors a way to potentially outperform a direct investment in the underlying asset class.

Steven Marshall, President, OpenSky Capital: I would add this whole shift from relative to absolute performance. Say what you want, but, in the end, performance always does matter. No one buys these products to only get their capital at the end. Nobody.

James Cook, Executive Vice President, Strategic Initiatives, Franklin Templeton Investments: Clearly there have been many more entrants: fund companies and others who have much broader distribution platforms. I think the growing knowledge and education among investment advisors and end investors will create more demand for these types of products.

François Hérou, Managing Director, Financial Products, RBC Capital Markets: Our experience is that it is demand driven. People are looking for a range of different investing options. They want to invest in

“Full currency protection has become an important feature for retail investors who have invested in foreign markets.”

François Hérou, RBC Capital Markets



foreign markets, in commodities, in equity and fixed income indexes, as well as in other asset classes with full currency and principal protection.

Full currency protection has become an important feature for retail investors who have invested in foreign markets and have seen the negative impact that a strong Canadian dollar has had on their foreign investments.

Which investor are these products right for?

Luke Seabrook: I don't think you can give an answer as to who is the right investor for these products because each PPN is just a wrapper. You have to look through the PPN because ultimately your variable return is going to be driven off different types of exposure — from funds to commodities to indexes to stocks. Each one has to be evaluated on its own merit. Obviously, the fact that there's an element of principal protection in it means that investors have a relative level of risk aversion, but there are principal-protected products that are designed for a more aggressive type of investor than just a GIC-alternative investor.

Can you give me an example?

Steven Marshall: We can't pigeonhole what type of client is buying this. We've seen high-net-worth investors with huge positions in areas they want exposure to. What we're hearing from clients and seeing from advisors is that it's good for a wide array of clients and they all have different needs and different wants to fix something in their portfolio or to get exposure to an area, but without all the risk.

James Cook: It all gets back to diversification. If the investor can get desired exposure to various asset classes within their risk-tolerance limits without having to pay for the principal

protection because they have a very good plan and can get a broad base, then they don't have a need for protection and the cost associated with it. But for those who don't think they can get that comfort or fit with their risk profile, this is a nice way to do it.

François Héroux: Conservative, knowledgeable investors looking to access a mix or blend of investments and geographic markets to achieve specific investment returns and diversification while protecting their invested capital. They are more applicable for investors with already large, diverse investment portfolios.

I've used the term "structured notes" but primarily we're talking about PPNs. One of the marketing features is the protection, but it seems that maybe that is not the most important part of it.

Luke Seabrook: I don't think so. Most investors are otherwise able to access the underlying holdings that the PPNs give them exposure to. One of the aspects of a PPN is giving people comfort, to a large degree. The volume has been generated in the more standard assets.

Nicolas Patard: I have to agree with that. When you look at the commodity notes that we've done, the size of these issues has been smaller than our index-linked or mutual-fund-linked issues. There's another way of looking at this. Every investor will have different risk profiles for certain parts of their money. I do think this goes beyond traditional classifications and breaking it down into what part of your money is risk-averse and what part of your money can be put at risk.

Steven Marshall: There are a lot of structures that we can bring out because of the capital

RESEARCH NOTES...

The Research Group of the Healthcare and Financial Services division of Rogers Media conducted an online survey, from March 2 to 20, among advisors who sell structured notes. A total of 125 surveys were completed, representing a margin of error of +/- 5% 19 times out of 20.

Which type of structured products do you sell?

- 63% structured or principal-protected notes
- 27% closed-end funds
- 14% saying ETFs
- 22% no response

guarantee and people can't buy them without the capital guarantee. In other words, there aren't markets that they can get access to, there aren't options strategies that they have access to, you can't purchase them unless you're an extremely large institutional investor.

And then you have other strategies that truly wrap around an asset that you could go out and buy yourself and track yourself — very similar to what mutual funds have always done.

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Luke Seabrook, BMO Nesbitt Burns



How do PPNs fit into a portfolio? Consider someone who is disappointed with low-return GICs. Is it realistic to think that they'll move a certain portion of their assets to a potentially higher-yielding mutual-fund or index-linked note? Are they buying the note rather than the underlying, be it a fund, an index or a commodity, using it as a kind of a portable alpha strategy placed over top of low-yield GICs?

Luke Seabrook: That is what some of them are doing. That's exactly to the point that I could buy a 5-year GIC, make 3-3/4% or I can potentially invest in protected exposure to a fund that's averaged 10% growth.

Steven Marshall: In the end, things have to be simple. It either replaces part of the fixed income book, or it replaces part of the equity. And then the advisor chooses which structure better suits their needs. Most of the products, other than commodities, are sold against the fixed income side. Everyone around the table has raised the same question: your choice is to leave 1.5% before inflation on the table. Is it worth it? You can argue: should I be paying \$15 to sell a stock online or do I hire an advisor that gives me advice? There's nothing for free in life.

François Hérou: A lot of people who buy PPNs are investors with significant portfolios, whether it's in equities, indexes or mutual funds. They roll some of their capital gains into the PPN to lock in the value of these gains. These investors are not going to sell their investments in mutual funds and equities to invest in a

**JAMES COOK, C.A.
EXECUTIVE VICE PRESIDENT, STRATEGIC INITIATIVES
FRANKLIN TEMPLETON INVESTMENTS**

James E. Cook serves as Executive Vice President, Strategic Initiatives, for Franklin Templeton Investments Corp. ("FTIC"). His responsibilities include oversight of Product Development, Strategic Account Management, Fund Accounting and Fiduciary Trust Company of Canada, as well as participating on the firm's Management Committee.

Prior to joining the Franklin Templeton organization in 1994, Mr. Cook worked with Coopers & Lybrand, Chartered Accountants, for 12 years in the general practice division where he achieved the level of principal. While at Coopers, Mr. Cook worked with a broad range of clients and specialized in financial institutions.

Mr. Cook graduated with a Bachelor of Commerce degree from Queen's University in Kingston, Ontario in 1982 and obtained his Chartered Accountant designation in 1984. Mr. Cook is a member of the FTIC Board of Directors and a member of the Board of Trustees for many of FTIC's mutual funds. He also serves as Chairman of the Fiduciary Trust Company of Canada and as Chief Financial Officer, Secretary-Treasurer, of Templeton Growth Fund, Ltd. and Franklin Templeton Corporate Class Ltd.

PPN under management: Note face value - approximately \$800 million (these notes are the Banks (CIBC, BMO, etc); Investment in our funds — approximately \$600 million.

Types of structures: All mutual fund linked notes. All but \$70 million are PPNs.

low-yielding GIC. They want to stay in the asset class. They want to lock in a portion of their underlying investments, as a safety net, into a PPN that is linked to an underlying market or mutual fund similar to what they already own.

Nicolas Patard: There are always going to be proponents saying that you should buy a mutual fund and hold that for the rest of your life. The problem is twofold: First, it's the market drawdowns and when you're in the middle of a down, that vision that you had maybe 10 years ago is a lot tougher to sustain when you get your monthly statement. Second is the cost of a GIC basically earning zero. What you have is a big challenge between a want — which is mutual-funds-type returns — and a need, which is the protection offered by GICs. I think this is where, on a risk-spectrum basis, you see notes appearing in the middle.

James Cook: To corroborate what you're saying, Nicolas, investors quite often make decisions at the wrong time of a cycle. The value of a PPN is: if you do get that 25% downturn, that's quite often when people will say, "That's it. That's all I can take. I've got to get out now." And they get out at that low, at the shock point, and they've lost their principal and they spend the next ten years just trying to get it back. With PPNs, they're likely to stay in that asset class.

We've got families of seg funds out there, for instance, that were all under water for quite a period of time and now all above water because people didn't redeem them because they knew they had the guarantee at the end of the seg fund life.

So why wouldn't people then just opt for seg funds or an index-linked GIC? Why would they move to a PPN?

James Cook: Segregated funds are insurance contracts that provide a number of benefits. If you are specifically and only looking for a 100% principal guarantee, then PPNs can be a more efficient mechanism that generally offers a different array of investment mandates.

Luke Seabrook: Some index-linked GIC returns are manufactured identically to some PPNs; let's not make any mistake about it. In some banks, the same groups often manufacture linked GICs and PPNs.

With PPNs, there are option-based structures, where you won't know the payoff until maturity and dynamic-leveraging structures, which can result in a quite different return profile from the underlying investment, over the same period. How do you compare them?

François Hérou: With option-based notes, the payoff is made following a static formula and is often made at the maturity of the note, although the investor can sell the note at a posted NAV at any time prior to maturity.

From a payoff standpoint, a CPPI (dynamic leveraging or Constant

RESEARCH NOTES...

Do you expect sales of PPNs to increase, decrease or stay the same in 2006?

- 32% increase
- 69% in total stay the same, decrease or don't know

FRANÇOIS HÉLOU MANAGING DIRECTOR, FINANCIAL PRODUCTS RBC CAPITAL MARKETS

François Hérou is a Managing Director with RBC Capital Markets and heads structured products marketing with the Financial Products Group. Prior to joining RBC in 2002, François held a variety of marketing positions in derivatives and structured products with a number of top financial institutions in Canada. François graduated with a B.Sc. of Civil Engineering from Laval University in 1986, received his MBA from McGill University in 1990 and is a CFA Charterholder since 1994. PPN under management: In excess of CAD \$5 billion.

Types of structures: Fixed income, equity, commodity and credit linked structured notes issued to both retail and institutional investors.

Proportionate Portfolio Insurance) utilizes a dynamic asset allocation between investing in bonds and in the underlying assets. It is a total return strategy in that both the price return and the distributions of the underlying assets are included in the payoff, whereas an option-linked note is a more passive exposure to an underlying

asset and tends to be a price return strategy.

With option-based notes, the NAV depends on a series of factors such as: the level of interest rates (which affects the value of the zero coupon bond that makes up the principal guarantee at maturity), and the value of the embedded option that determines the value of the note's interest payment. In many cases, the underlying asset of the option-linked note fluctuates by a specific amount, whereas the NAV of the note may fluctuate by a different amount. This is due to a variety of factors that impact the NAV calculation of an option-based note prior to maturity.

With CPPIs, there is a stronger link between the NAV of the note and the performance of the note's underlying assets. This is due to the fact that the dynamic investment allocation of the CPPI is similar to a direct investment in the underlying assets.

Both notes are completely different in terms of payoff and risk profiles. In a lot of cases, advisors may purchase both types of notes for the same client, who may wish to invest a portion of their portfolio in an income-generating note, with a dynamic allocation strategy, and another portion of their portfolio in a note that has a more passive exposure to the underlying asset and whose interest is paid at maturity.

Luke Seabrook: To add to that, the CPPI can be distribution and total return. The popularity has been in distribution-paying CPPI-based models just because Canadian retail investors are interested in yield.

It doesn't dictate that you can only do one. The other way I would describe it is that a CPPI-based structure is what we call path-dependent (dependent on how the underlying has performed since issue) and some option-based structures don't have path dependencies. So, regardless

"There are always going to be proponents saying that you should buy a mutual fund and hold that for the rest of your life."

*Nicolas Patard,
National Bank Financial Group*



**STEVEN MARSHALL
PRESIDENT, OPENSKY CAPITAL**

Steven Marshall founded OpenSky Capital on January 2004 and has held the position of president since that date.

He is responsible for the company's overall operations, including sales, marketing and client services. He is directly involved in the development process and handles all negotiations with issuers and other third parties who do business with OpenSky Capital.

Before joining OpenSky Capital, Steven held the position of Senior Vice President, Wealth Management with Monrusco Bolton Investment. His primary responsibilities included management of the sub-advisory division, management of the high-net-worth division and the development of new partnerships. He was also a member of the management committee. Prior to joining the firm, Steven worked for a large mutual fund company initially as Vice President, Regional Sales and then as Vice President, Sales, where he managed over \$2.2 billion in sales. He was involved in strategic planning, product development, budgets, marketing and corporate development. Between 1990 and 1997, he held various positions at a Canadian chartered bank.

Steven earned a B.A. in Economics from the University of Windsor and an Executive Sales Management Diploma from Queen's University.

PPN under management: 1.9 billion

Types of structures: Zero coupon call options and CPPI

of what the underlying fund does at maturity on an option-based structure, generally the investor can figure out very easily what the payout of that note is going to be.

In a CPPI, their exposure to an asset (be it in an index basket of stocks or mutual funds) is moving around all the time and they may be getting increased exposure in a robust market or decreased exposure in a declining market.

Jeffrey O'Brien: We've done both types of structures and we've migrated more now to the CPPI structure because investors and advisors recognize the benefits that CPPI offers in this current interest-rate environment. With the option-based structures, because interest rates are so low, there's not as much money left over to spend on an option after investing a large portion of the proceeds in the strip coupon, so often there's some sort of cap on returns available to investors. With the CPPI structure, although it won't perform exactly the same way as the underlying, not only is there a cap on returns but it also gives the investor the potential to actually outperform what the underlying investment does.

Steven Marshall: We've done both and we'll continue to do both. It really depends on the underlying. What we found is when it's a simple position where it's managed money or you're taking positions in indexes and you have a long-term view towards those investments, CPPI is a great tool. It allows you to use leverage.

What we found also is that there are some underlying investments that you should only use with option strategies. We use them for payout products. We use them for options that you don't have access to.

When you said they use options for payout

products — what does that mean?

Steven Marshall: There are options strategies out there now where you can have yearly payouts. You can have minimum payouts; you can have maximum payouts.

Luke Seabrook: Just to be clear, the option strategy that Steven is referring to is different from the option-based product we were referring to. The option strategy that Steven is referring to is where the client is going long and short options in a protected basis that's generating premiums that can be used to pay out coupons, which is different than an option-based, quasi-linked GIC-type strategy.

How do you explain the drivers in each strategy?

Nicolas Patard: It's a transparency issue. We go to great lengths to explain the payout structures more comprehensively. What were very complicated formulas have been replaced by client-friendly scenarios that outline the return the investor will receive given the performance of the underlying

RESEARCH NOTES...

How do you perceive your clients' comfort level with the following investments? (The percentage of clients who are "very comfortable.")

- equity mutual funds: 58%
- GICs: 51%
- segregated funds: 27%
- stocks: 22%
- index-linked GICs: 20%

**JEFFREY O'BRIEN
PRESIDENT AND CEO, ONE FINANCIAL CORPORATION**

Immediately prior to leading ONE Financial, Jeffrey O'Brien was an Investment Advisor with RBC Dominion Securities where he managed portfolios for small to mid-sized institutions and high-net-worth clients. While working at RBC, Jeffrey recognized the need for investment products that would provide Canadian investors with a safer way to earn attractive returns on their investments. He thus founded ONE Financial Corporation with the goal of creating innovative investment products offering investors unique benefits previously unavailable in Canada. Jeffrey is a Chartered Financial Analyst (CFA) and holds an Honours Bachelor of Commerce degree from McMaster University.

PPN under management: Approximately \$285 million
Types of structures: CPPI with Highest NAV Guarantee
 CPPI with Highest NAV Guarantee and ROC quarterly cashflows

investment in a very transparent way. I'm not saying we can predict the return. I'm saying the investors will know what to expect in different scenarios.

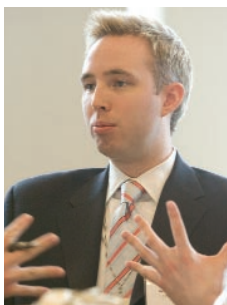
James Cook: Our job as distributors or manufacturers is to figure out what are the most important points that advisors need to know: cost; fees; what the expectations are around the product; and how it should

perform in certain markets. And then we've got to go out and prove that. I think that's where the jury is still out.

Steven Marshall: Performance has actually been a lot better in some structures than anybody could have ever imagined, whether they're in CPPIs or option-based strategies. Everyone is getting into the nitty-gritty because we're using words like "options" and "CPPIs." To go back to the fund side, does the average investor really want to compare each manager, and ask why the manager bought 3% of Stock X and not 3.5%? I think what's important is when they look at a product they say, "Okay, this is what it's invested in — this is how it should do." In other words, if you buy a value fund when it's a value market, you should do very well with it; you buy a growth fund in a growth market, you should do well with it. What we have to do is educate advisors on where notes fit in a portfolio and how they're going to act in a certain market.

"We've migrated more now to the CPPI structure because investors and advisors recognize the benefits that CPPI offers in this current interest-rate environment."

Jeffrey O'Brien, ONE Financial Corporation



**NICOLAS PATARD
MANAGING DIRECTOR OF GLOBAL EQUITY DERIVATIVES
NATIONAL BANK FINANCIAL GROUP**

Nicolas Patard, Managing Director of Global Equity Derivatives for National Bank of Canada, is in charge of marketing and structuring global structured products. Nicolas has eight years of experience in marketing and structuring derivatives. Prior to joining National Bank in 2000, Nicolas worked as an analyst in derivatives for major American and European firms. He graduated from McGill University with a Bachelor of Commerce and holds a Master of Science in Finance degree from HEC.

National Bank has been involved in structured products since the mid-1990s. From the traditional index-linked GICs, National Bank has evolved into more complex products, consecutively bringing to the Canadian market callable notes, mutual-fund-linked notes as well as commodity notes. Currently, National Bank's structuring efforts span markets around the globe and are linked to all major investment asset classes (equities, bonds, commodities, currencies and alternative investments). National Bank's latest development was the filing, in early 2006, of a preliminary base-shelf prospectus enabling National Bank to issue notes that offer less than 100% principal protection.

Types of structures: PPNs using both option-based as well as dynamic hedging ("CPPI") structures.

François Héroux: A good understanding of the main factors that affect the NAV of a note, be it an option-based or CPPI, is important in understanding how the NAV of the note correlates with the fluctuations of the note's underlying assets. As discussed earlier, the valuation factors differ in the case of CPPI and option-based notes. For all investment products, it is important for investors to understand what parameters drive the value of the investment. We explain to advisors the various valuation parameters via educational materials, formal branch presentations, and one-on-one meetings. We also provide them with website access to pertinent information and a 24-hour hotline that allows them to call for assistance at their convenience. We provide a daily NAV for the notes and all answers required for advisors to understand the note and explain it to their clients.

Steven Marshall: All these products are built with the premise of absolute return. In other words, we've said here's the worst it can get; with some of the products we've said this is the most you can get; and with other products we say there's no limit to how much you can get but all of us say this is the worst you can get. And you get banks to back that up. It's very simple.

I think one of the issues we're having is that we're all scattered in "other" (fund categories). This is a huge problem for advisors because they don't know where it goes. And they say how do I know how it's doing because it's in "other." So you get a CPPI wrapped around a balanced fund, for example, or a value fund or an income trust fund and you'll be compared to a Chinese growth fund or an India fund or a hedge fund, which is based on one strategy.

James Cook: I think everybody is getting more sophisticated. If you look at any mutual fund marketing piece, they all show the top-ten stocks, the same performance data, they track against an index — they've done all that so that every bar graph looks the same as every other graph. So it's evolved, but that's taken 25 years for us to get to that consistency level.

That should be the goal in this space as well, so you know that if an advisor is selling two or three different notes from two or three different manufacturers, then they're going to get similar types of information that will help them understand how their note is progressing, why it's progressing and whatnot.

Let's look at what the disadvantages or risks could be. Number one is that you're only going to get a guarantee. How do you communicate that?

Jeffrey O'Brien: I believe advisors are sophisticated and understand that, but we do speak

toward the risk, which in the case of the CPPI structure is monetization — this is the biggest concern among advisors. And there are a couple of things that we have done to mitigate this risk. First, offering Canada's only family of notes allows investors to switch between notes within the family without incurring any early sales charges, and to move from a note that might be monetized to one that's positioned for strong performance. Also, our notes provide the potential for a high-income stream and are the only ones in Canada to automatically guarantee to pay the highest NAV achieved throughout the term. This helps to ensure that investors have a greater chance to receive a positive return on their investment.

Luke Seabrook: There's the transfer of the risks that exist with the asset that you're linking to as far as your variable return is concerned. So if you're linking to mutual funds, there's all the risk that are associated with the investment strategy, with the manager,

RESEARCH NOTES...

What underlying investments in a PPN are most suitable for your clients?

- **Mutual funds (53%)**
- **Stock baskets (44%)**
- **Income trusts (43%)**
- **Indexes (39%)**
- **Commodities (30%)**
- **Hedge funds (18%)**

LUKE SEABROOK EXECUTIVE MANAGING DIRECTOR, FINANCIAL PRODUCTS BMO NESBITT BURNS

Luke Seabrook is head of the Structured Products Group and Investor Derivative Origination Group at BMO Nesbitt Burns. These groups are responsible for development and marketing of equity derivative, credit derivative, and fixed income derivative-related products, including linked-note products, in Canada, the U.S. and Europe. These businesses cover all aspects of the marketplace including retail, high-net-worth and institutional clients.

Prior to joining BMO Nesbitt Burns in 2004, Luke was Executive Director of Equity Structured Products at CIBC World Markets, and Vice President of Financial Institutions at Citigroup. Luke is a graduate from the Ivey School of Business at the University of Western Ontario.

Types of structures: Virtually all types seen in the market — option based, CPPI, etc.

with performance, currency risk, if you're linked to a global asset and there hasn't been a currency hedge put in place... Those types of risks don't go away insofar as generating your variable return, even if your capital is guaranteed.

When you're using an option-based program, what about other risks to the variable return, such as caps or participation rates? And with CPPI, there's also a variable exposure to the underlying.

Luke Seabrook: If you're using an option strategy, because it's not path-protected, you are guaranteed to get that exposure. In CPPI, you have your exposure moving around and exposure can move up or down to some portion, depending on the strategy or the product you're buying.

Nicolas Patard: In general, I think the caps or the limitations or the rates of participation in an option-based structure are fairly well disclosed, whether it is callable or capped. If we go back to the mid-1990s when index-linked GICs started out, it was clear you either had a cap at 30% or you had a 75% participation in the index.

That's getting to this point about transparency. How can information statements serve as more useful documents for advisors and for clients?

François Héroux: It is our policy that for each note we provide detailed disclosure informa-

tion in all the Information Statements that we produce. The information in this document contains the same information about the transaction relevant to retail investors that would be listed in a prospectus.

Jeffrey O'Brien: There are a couple of examples of mutual fund prospectuses for guaranteed products in Canada. I don't know about my colleagues here but I find the level of transparency in those documents to be generally less than the transparency in the information statements prepared by the guarantor of our notes.

Luke Seabrook: I think there are good levels of disclosure in these documents, which is a result of the reputation risk that the banks are taking in creating these products. It is difficult, though, to try and articulate in some of these structures what the fees are. A lot of the products that we create are easier to identify the fees because we are dealing with funds and we can reference what the incremental cost is versus what a direct fund investment is.

Nicolas Patard: If you look at it on a historical basis, in the mid-1990s investors would walk into a bank branch and buy an index-linked GIC by signing one page, basically. Now, you have a document that has evolved from being a one-pager to something that is 20, 25, 30 pages. Every one of us screens each other's deals so there's a natural tendency to get to a higher level of standardization.

Luke Seabrook: I think market forces also help significantly. We find compliance in many of the distribution channels to be much more involved than it used to be. You have to come in through the due diligence committees at each of the distributors to be able to get your products on the shelf.

"Performance has actually been a lot better in some structures than anybody could have ever imagined, whether they're in CPPIs or option-based strategies."

Steven Marshall, OpenSky Capital



Shouldn't there be a breakout of fee disclosure because you would want to know, for example, what the offering costs are on the individual product comparable to, say, a closed-end fund? You probably want to be able to disclose what the management fees are within the product. And then there would be minimum and maximum fees, depending on the leverage used.

Steven Marshall: We've come out with over 40 products and we've gone through all these due diligence committees and they're pretty clear on what they want to see in the documents. We've had to adjust/change some green sheets to answer some of their needs and we're more than happy to do it. The market forces are forcing us to standardize. They're setting the bar higher all the time and we're more than happy to comply. I don't think any firms will let you in if you're not clear on fees; who gets what and what this product is going to do.

Luke Seabrook: I agree and I think that we're all doing our best to continually improve the fee disclosure.

Nicolas Patard: Investors are making a decision on day one to buy a capped product with the associated payoff. Thus, if they are capped at 75% and the underlying investment performs at 100%, the investor will leave 25% on the table. However, investors have to remember the reasons why they invested in this type of strategy in the first place and the opportunity the PPN gave them to get up to 75% while having their capital protected.

If it took 25 years for the mutual fund industry to come up with the graphs, the presentations, that you could actually make a choice among products in the same

categories. Presumably, one could develop something like that for PPNs so that at least investors would know which issuer they wanted to go with, even though the individual products might be quite different, one from another, depending on the underlying.

Luke Seabrook: This market is not forming in Canada in a vacuum. This is a huge market. I was at a conference in London a few weeks ago, where their retail structured products base is at 450 billion euros in Europe, and there was 150 billion gross done last year for 2005. It's orders of magnitude bigger than here in Canada and they don't have a standard. There really isn't a standard that exists globally that we could transplant into Canada.

It's not like a fund that you work till you launch and it's out there for 50 years. These things are available for six and eight-week selling periods and they're very reactive to market opportunities, which is good for the investors because they can take advantage of situations with these products. But they're all so different. You make a slight tweak to one of these things and I would argue that it's inappropriate to try and compare it to something that was done just two months earlier that was slightly different.

James Cook: I think that's one of the intriguing things about notes. We've got a dozen to 15 notes out there. Other than one launch that we've repeated a couple of times, every one of them had different features, different tweaks, and reasons for different terms, different payouts or whatever. We're hearing from investors: "I like it but if it just did this instead of that, then I'd really like it." So the financial engineers go through the math to figure out what we can do and a new product hits the streets. Trying to compare that to the one you had

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just out there before would be very, very difficult because that one feature, as Luke said, is fundamentally the difference between the two notes and that's what you're now selling.

Steven Marshall: We react naturally to the demand that's out there, but then we react to the change in market when we bring out the structures. I guess the easiest one to look at is commodities. Just look at how these deals on commodities change so fast. You can have an opportunity for two weeks and it's there but it only lasted two weeks. That's the beauty of these products.

James Cook: These are good products. I think we all clearly understand that the easier we make these things to sell, by providing as much transparency and consistency in disclosure as possible, the more popular they will become. We're all similarly motivated. We need to create an easy solution to this that everybody will rally around.

Jeffrey O'Brien: You've got to remember who is actually putting out these documents though. All these information statements are written by issuers who are large global financial institutions, they are not written by product manufacturers. All of these banks are in it for the long term, they all have long-term business plans with this

product space and it all comes back to reputation and the risk of putting your brand out there. And they're not going to ever want to do anything that breaks their trust and hurts their business with retail investors or advisors.

Any concluding remarks about the products or how they're being marketed?

Jeffrey O'Brien: We've certainly noticed the advisors are definitely becoming more educated. It's been four years since we launched our first note, and back then nobody new what a CPPI was, but most of the advisors we speak with today are definitely more educated on the different types of structures and the different things to be aware of with each of these products.

Steven Marshall: Advisors have told us that this is a viable investment product that should be in portfolios. A lot of them have done their homework. And they're looking at these changing markets as very exciting times. All of this is going to increase the innovation and increase the choices, which will help advisors build better portfolios for their clients.

James Cook: The other thing that's really in our advantage here is the investment community in Canada is a small community relative to some. You've got a huge proportion of the industry sitting around this table, and I think it creates an environment where we can develop these products, increase the knowledge, and increase the education at fairly rapid clip in a fairly organized way.

"The easier we make these things to sell, by providing as much transparency and consistency in disclosure as possible, the more popular they will become."

James Cook, Franklin Templeton Investments



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