

Dear client

This letter provides a summary of some of the protection available to customers of National Bank Independent Network (NBIN), a division of National Bank Financial Inc. (**NBF**), for their brokerage accounts and other trading activity. NBF is a wholly owned subsidiary of National Bank of Canada.

The enclosed is our understanding of the relevant statutory provisions applicable to all investment dealers faced with a bankruptcy.

While we believe that the information we are sharing with you is accurate it should not be relied upon as a legal or financial opinion. We would encourage you to consult with your Investment Advisor.

Applicable Rules and Regulations to NBF

NBF is one of Canada's largest investment dealers. Through its NBIN division, it provides trading, clearing and custodial services as well as other administrative services to its customers and to independent Introducing Brokers, Portfolio Managers and Investment Fund Managers

NBF is a member of the New Self-Regulatory Organization of Canada (the **New SRO**) which is the self-regulatory organization formed following the amalgamation of the Investment Industry Regulatory Organization of Canada (**IIROC**) with the Mutual Fund Dealer Association (**MFDA**) and the organization recognized by all Canadian securities administrators to oversee securities dealers and trading activity on equity and debt marketplaces in Canada¹.

NBF² as a member of the *New SRO*, is subject to stringent regulation, including detailed rules about the conduct of a member's business. NBF and its related dealer companies provide the *New SRO* with monthly financial reports, NBF's audited annual financial statements. In addition, NBF provides a detailed annual joint regulatory financial questionnaire and report for NBF and its related dealer companies, together with NBF's external independent auditors reports which include specific financial statement reviews. The *New SRO* reviews these reports to monitor compliance with its rules and has broad powers to examine and investigate the books and records of its members.

As a general observation, in a situation where a member of the *New SRO* is required to cease its operations due to bankruptcy, customers' assets are protected by various rules established by the *New SRO* and assets would generally be transferred to another member firm.

¹ The name "New Self-Regulatory Organization of Canada" is the temporary legal name of the newly consolidated SRO. A new permanent name will be chosen later in 2023

² For simplicity we will refer only to NBF although the analysis would be common to all members of the New SRO.

Rules and regulations exist to protect customer assets held with a broker-dealer in the highly unlikely event of a credit problem associated with a broker-dealer such as NBF. The summary below is not intended to be an exhaustive discussion on customer protection.

Segregation of Securities

The *New SRO* rules and regulations³ require that fully paid and excess margin client securities in brokerage and other securities accounts at NBF be segregated and identified as being held in trust for clients. The segregated securities cannot be used by NBF in its business. This segregation helps to minimize the risk of loss of assets in event of bankruptcy.

The members of the *New SRO* must undertake a daily compliance review of securities under segregation and take action to settle any deficiencies.

To the extent permitted by the *New SRO* rules,⁴ NBF uses free credit balances in its business. Under those rules, free credit balances exceeding specified limits must be segregated by NBF and held in cash in a separate account at an acceptable institution or in certain short-term government debt securities.

The rules regarding use of customer securities are designed to work together so that the assets held by a broker-dealer are at least equivalent to the aggregate net equity claims of its customers.

Risk Adjusted Capital and Broker-Dealer Notification Rules

A dealer must maintain a minimum level of risk adjusted capital in order to continue operation and must file regular reports regarding its capital levels⁵. In determining its risk adjusted capital, assets are valued conservatively, with most financial assets having their value discounted.

A dealer must notify the *New SRO* immediately if its liquidity, capital or profitability drops below specified “early warning levels”, and specific corrective measures must be taken.⁶ The “early warning levels” are significantly above where a broker-dealer would be at risk of default.

The *New SRO* reviews NBF’s books and records to verify that they are in compliance with regulatory requirements.

Provided that NBF complies with the minimum capital and segregation requirements, it should be able to return all fully paid and excess margin securities and client non-invested monies in an orderly and timely fashion to customers in the unlikely event that NBF ceases operations due to bankruptcy.

³ Rules 4312 and 4314 of the Investment Dealer and Partially Consolidated Rules

⁴ Rule 4382 to 4386 of the Investment Dealer and Partially Consolidated Rules

⁵ Rule 4100 of the Investment Dealer and Partially Consolidated Rules .

⁶ Rule 4100 of the Investment Dealer and Partially Consolidated Rules .

Audit and Internal Control

NBF, as wholly-owned subsidiary of National Bank of Canada (the “Bank”) is subject to the Bank’s Audit and Risk Management Committee (the “Audit Committee”).

The Audit Committee reports to the Board of Directors of the Bank and reviews its financial statements, audit processes and management information systems and all other material financial information, in order to ensure their integrity, the effectiveness of processes and compliance with applicable accounting standards.

The audit Committee reviews the effectiveness of the internal controls and recommends measures to correct all important control problems identified during this review, oversees the work of the internal auditor and the independent auditor and acts as an intermediary between the Board and the persons responsible for the independent oversight that are internal audit, external audit and corporate compliance.

The Audit committee also oversees the work of internal and external auditors, supervises the financial reporting and analysis process, ensures the corporate compliance of the Bank, supervises its internal controls and risk management and examines the certifications, declarations and/or reports required by a regulatory authority.

Pursuant to *National Instrument 52-110 respecting Audit Committees* adopted by the Canadian Securities Administrators, all committee members of the Audit Committee are required to be independent, so no member is an employee of the Bank. The shareholders of the Bank on the recommendation of the board of directors have appointed Samson Bélair / Deloitte & Touche LLP (“Deloitte”) as the independent auditors of the Bank. The independent auditors have unrestricted access to the Audit Committee to discuss any matter related to their mandate.

For additional information on internal controls, please find attached 3416 CSAE independent assurance report as of October 31, 2022 prepared by our independent auditors

Bankruptcy and Insolvency Act - BIA

The Bankruptcy and Insolvency Act (Canada) has specific rules dealing with the liquidation of a securities firm such as NBF in the highly unlikely event that it faces credit difficulties.⁷ These rules have been adopted to simplify and streamline the administration of a bankrupt securities firm’s estate and to avoid the uncertainty, costs and time consuming situations which prevail before the adoption of the act in 1997.

Broadly speaking, these rules operate in the following manner.

The property of a bankrupt securities firm is divided into three categories:

- **Customer name securities** are securities which are registered in the customer's name in records maintained by or on behalf of the issuer of those securities and are in non-negotiable form (e.g. physical shares certificates). These securities are to be returned to the customer after satisfaction of that customer's debts payable to the firm. In general, NBF does not hold customer name securities.
- The **customer pool fund** consists of cash and securities (which generally includes shares, debentures and other financial assets), held by the firm for:
 - the securities account of its customers,
 - as collateral for derivatives and other eligible financial contracts, and
 - the firm's own account.

The customer pool fund also includes investments of the securities firm in its subsidiaries but excludes customer name securities or other eligible financial contracts to which the securities firm is a party.

- The **general fund** consists of all remaining property of the securities firm, such as non-customer receivables, furniture and fixtures.

It is important to note that the customer pool fund is paid out before any other creditors are paid at all.

The customer pool fund is allocated first to the costs of administration of the bankruptcy, but only to the extent that sufficient funds are not available in the general fund to cover such costs.

The customer pool fund is then allocated to customers⁸ in proportion to their net equity. Under the BIA, **customer** is defined very broadly and includes any person who has cash or other assets in a securities account with the securities firm, excluding customer claims that by agreement or operation of law are part of the firm's capital and subordinated claims.

A customer's **net equity** is the amount the securities firm would owe the customer if its account (excluding customer name securities) had been liquidated at the close of the business on the date of bankruptcy, net of debts payable by the customer to the firm. Rehypothecation of a customer's securities is not a factor in determining that customer's net equity.

To the extent that securities of a particular type are available in the customer pool fund, the trustee must satisfy customer claims to securities of that type with such securities, up to the appropriate portion of their net equity. The trustee may satisfy customer claims to securities of a particular type in whole or in part with securities of such type and can exercise its powers to buy securities in order to accomplish this.

Until customers' net equity claims are paid in full, general creditors of the liquidating securities firm cannot access the customer pool fund. In other words, customer net equity claims are senior to the claims of all unsecured creditors. Subject to the claims of secured creditors and preferred creditors, and any customer net equity claims not satisfied out of the customer pool fund and payments from CIPF, the general fund is available to satisfy the claims of unsecured creditors.

⁸ Except customers whose misconduct caused or materially contributed to the insolvency of the firm.

A trustee in bankruptcy of a securities firm may exercise broad powers to deal with the assets in the customer pool fund and general fund in consultation with the Canadian Investor Protection Fund, including buying and selling securities (other than customer name securities) and transferring securities accounts to another securities firm.

It is possible that a securities firm could attempt to avoid liquidation under the BIA rules by attempting to reach a compromise with its creditors under the BIA or the Companies' Creditors Arrangement Act (**CCAA**). If this occurred, customers who have entered into eligible financial contracts with the firm that contain close-out and netting rights may benefit from certain protections under the BIA or the CCAA.

Canadian Investor Protection Fund - CIPF

In the event a securities firm does not have sufficient assets to meet customers' net equity claims, CIPF covers the shortfall for eligible customers to a maximum of \$1,000,000 per customer. For more details, an explanatory brochure describing the nature and limits of coverage is available from your Investment Advisor or directly from the CIPF coverage can be found on its website, www.cipf.ca.

As a general observation, it is important to note that the analysis would be common to all investment dealers faced with a bankruptcy. Upon the occurrence of a bankruptcy a trustee in bankruptcy would be appointed to administer the affairs of the affected investment dealer. While applicable legislation establishes the broad parameters for the administration of a bankrupt investment dealer's business, the precise steps to be followed would be determined by the appointed trustee.

Overview of National Bank

Founded in 1859, National Bank of Canada ("NBC" or "the Bank") offers financial services to individuals, businesses, institutional clients and governments across Canada and is one of Canada's six systemically important banks and among the most profitable banks on a global basis by return on equity⁹.

NBC is a chartered bank under Schedule 1 of the Bank Act (Canada) and is regulated by the Office of the Superintendent of Financial Institutions Canada (OSFI).

In accordance with the Bank Act (Canada), OSFI is mandated to protect the rights and interests of the depositors. Accordingly, OSFI examines and enquires into the business and affairs of the banks, as deemed necessary, to ensure that the provisions of the Bank Act (Canada) are being satisfied and that the NBC is in sound financial condition. In addition, OSFI is responsible for applying the Basel Accord in Canada.

⁹ National Bank 2022 Annual Report available at <https://www.nbc.ca/content/dam/bnc/a-propos-de-nous/relations-investisseurs/assemblee-annuelle/2023/na-annual-report-2022.pdf>

NBC is one of the 6 Canadian Domestic Systemically Important Banks (D-SIBs)¹⁰ and as such, NBC has to comply with an extensive set of regulatory measures used to manage systemic risks. NBC, along with the other major Canadian banks, must maintain various minimum capital and liquidity ratios established by OSFI.

Credit Ratings

Credit ratings assigned by ratings agencies represent their assessment of the Bank's credit quality based on qualitative and quantitative information provided to them. As provided in its 2022 Annual Report, the Bank's Long-term Deposits stand in the "AA" segment. The Bank's credit ratings are posted on the Bank's website.¹¹

¹⁰ By definition, a domestic systemically important bank (D-SIB) is a bank that could disrupt the domestic economy should it fail. Canada currently has six D-SIBs. D-SIBs are so important to the functioning of the financial system and the economy that they cannot be wound up under a conventional bankruptcy and liquidation process should they fail. The failure of any one of Canada's D-SIBs, with the potential loss of financial services, even for a short period of time, could have a serious impact on Canada's economy. Source: <https://www.cdic.ca/what-happens-in-a-failure/resolution-of-large-banks/large-banks-d-sibs/>

¹¹ <https://www.nbc.ca/en/about-us/investors/investor-relations/capital-debt-information/credit-ratings.html>