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CSA Notice and Request for Comment

Proposed National Instrument 93-101 *Derivatives: Business Conduct*

Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

April 4, 2017

Introduction

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a 150-day comment period, expiring on September 1, 2017:

- Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the **Instrument**);

- Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the **CP**).

Collectively, the Instrument and the CP are referred to as the **Proposed Instrument** in this Notice.

We are issuing this Notice to solicit comments on the Proposed Instrument. We welcome all comments on this publication and have also included specific questions in the Comments section.

The CSA intends to collaborate with the Bank of Canada, the Office of the Superintendent of Financial Institutions (Canada), and the Department of Finance (Canada) on the Proposed Instrument throughout its development.

We are also in the process of developing a proposed registration regime for derivatives dealers, derivatives advisers and potentially other derivatives market participants. We expect to publish Proposed National Instrument 93-102 *Derivatives: Registration* and a related companion policy (collectively the **Proposed Registration Instrument**) for comment during the consultation period for the Proposed Instrument.

We have extended the comment period on the Proposed Instrument to 150 days in order to allow investors, derivatives market participants and other stakeholders an opportunity to consider both of the proposed instruments before the comment period for the Proposed Instrument expires.

Background

In April 2013, the CSA published for comment a consultation paper, CSA Consultation Paper 91-407 *Derivatives: Registration* (the **Consultation Paper**), that outlined a proposed registration and business conduct regime for derivatives market participants.

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Based on our consideration of comments received on the Consultation Paper as well as our review of developments internationally, including the introduction of registration and market conduct regimes for swap dealers and major swap participants in the U.S.,[1] we have developed the Proposed Instrument and are in the process of developing the Proposed Registration Instrument for the purpose of adopting a harmonized derivatives registration and business conduct regime across Canada.

The CSA have chosen to split the proposed derivatives registration and business conduct regimes into two separate rules. This approach is intended to ensure that all derivatives firms remain subject to certain minimum standards in relation to their business conduct towards their customers and counterparties.

The Proposed Instrument applies to a person or company that meets the definition of "derivatives adviser" or "derivatives dealer" regardless of whether it is registered or exempted from the requirement to be registered in a jurisdiction.

Substance and Purpose of the Proposed Instrument

The CSA have developed the Proposed Instrument to help protect investors, reduce risk, improve transparency and accountability and promote responsible business conduct in the over-the-counter (**OTC**) derivatives markets.

During the financial crisis of 2008, the inappropriate sale of financial investments led to major losses for retail and institutional investors. The International Organization of Securities Commissions (**IOSCO**) noted in 2012 that "until recently, OTC derivatives markets have not been subject to the same level of regulation as securities markets. Insufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008."[2] Since the financial crisis, there have been numerous cases of serious market misconduct in the global derivatives market including, for example, misconduct relating to the manipulation of benchmarks and alleged front-running of customer orders.

The Proposed Instrument establishes a robust investor protection regime that meets IOSCO's international standards and takes into account CSA jurisdictions' commitments to create a derivatives dealer regime that is also consistent with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets.[3] The Proposed Instrument will help to protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices.

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[1] In this Notice, we use the terms "swap dealer" and "major swap participant" to refer to both swap dealers and major swap participants regulated by the Commodity Futures Trading Commission (**CFTC**) and security-based swap dealers and major security-based swap participants regulated by the Securities and Exchange Commission (the **SEC**). In Canada, the distinction between security-based swaps and other swaps will generally not be relevant.

[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf (DMI Report) at p 1.

[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD497.pdf (DMI Implementation Review) at p. 13.

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The Proposed Instrument is intended to create a uniform approach to derivatives market conduct regulation in Canada and will promote consistent protections for market participants regardless of the type of firms they deal with while also providing that persons or companies that are subject to requirements under the Proposed Instrument are subject to consistent regulation that does not result in a competitive advantage.

A person or company is subject to the Proposed Instrument only if it is a "derivatives adviser" or a "derivatives dealer". As described below in the Summary of the Instrument, generally this is determined using a test to determine if the person or company is in the business of trading or advising in OTC derivatives.[4] Furthermore, a person or company that may be in the business of trading in OTC derivatives may nevertheless be exempt from the requirements of the Proposed Instrument if they qualify for the end-user exemption described further below. Finally, even if a person or company is subject to the requirements of the Proposed Instrument, those requirements are tailored depending on the nature of the dealer or adviser's derivatives party (refer to the description of the two-tiered structure of the Instrument, below).

The Proposed Instrument sets out a comprehensive regime regulating the conduct of derivatives market participants, including requirements relating to the following:

- Fair dealing
- Conflicts of interest
- Know your client (KYC)
- Suitability
- Pre-trade disclosure
- Reporting
- Compliance
- Senior management duties
- Recordkeeping
- Treatment of derivative party assets

Many of the requirements in the Proposed Instrument are similar to existing market conduct requirements applicable to registered dealers and advisers under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) but have been modified to reflect the different nature of derivatives markets.

Much like NI 31-103, the Proposed Instrument takes a two-tiered approach to investor/customer protection, as follows:

- certain obligations apply in all cases when a derivatives firm is dealing with or advising a derivatives party, regardless of the level of sophistication or financial resources of the derivatives party; and

- certain obligations:

    - do not apply if the derivatives firm is dealing with or advising a derivatives party that is an "eligible derivatives party" and that is not an individual, and

    - apply but may be waived if the derivatives firm is dealing with or advising a derivatives party who is an "eligible derivatives party" and is an individual.

[4] Only those OTC derivatives set out in the applicable Product Determination Rule are relevant.

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The concept of "eligible derivatives party" and the extent to which obligations do not apply, or apply unless waived, when dealing with or advising an eligible derivatives party are explained in Part 1 of the summary of the Instrument below.

Summary of the Instrument

Part 1 – Definitions

Part 1 of the Instrument sets out relevant definitions and principles of interpretation.

Some of the most important definitions in the Instrument are as follows.

Derivatives adviser and derivatives dealer

The definitions of "derivatives adviser" and "derivatives dealer" incorporate a "business trigger" similar to the business trigger for registration in Canadian securities legislation.

As previously mentioned, it is important to note that the Instrument applies to a person or company that meets the definition of "derivatives adviser" or "derivatives dealer" regardless of whether they are registered or exempted from the requirement to be registered in a jurisdiction. This is intended to ensure that certain derivatives market participants that may benefit from an exemption from registration in certain jurisdictions nevertheless remain subject to certain minimum standards in relation to their business conduct towards their customers.

Clause (b) in the definitions of "derivatives adviser" and "derivatives dealer" has been included since the Proposed Registration Instrument may designate as or prescribe additional entities to be derivatives advisers or derivatives dealers based on specified activities (e.g., trading with non-eligible derivatives parties or engaging in certain market-making activities).

Derivatives party

In the Proposed Instrument, the term "derivatives party" refers to a derivatives firm's counterparties, customers, and other persons or companies that the derivatives firm may deal with or advise (e.g., affiliates or other derivatives firms).

Eligible derivatives party

The term "eligible derivatives party" refers to those derivatives parties that do not require the full set of protections afforded to "retail" customers or investors, either because they may reasonably be considered sophisticated or because they have sufficient financial resources to purchase professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm.

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As currently drafted, the definition of "eligible derivatives party" is generally consistent with the current regulatory regimes in the U.S. and Canada in relation to OTC derivatives.[5] In addition, the eligible derivatives party concept should be familiar to market participants because it is similar to the definition of "permitted client" in NI 31-103, with a few modifications to reflect the different nature of derivatives markets and participants.

We are seeking comment on a number of elements of the definition of "eligible derivatives party" and have included specific questions about the definition in the Comments section, including a question related to the proposed definition of "institutional client" included in the CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients* (**CSA Consultation Paper 33-404**) published in April 2016.

As the CSA staff responsible for CSA Consultation Paper 33-404 continue to review comments received during the consultation period and engage in various stakeholder consultations, we propose to monitor the work on this project, and may recommend amendments to the Proposed Instrument at a later date based on this work.

Part 2 – Application of the Instrument

Part 2 of the Instrument sets out a number of provisions relating to the application and scope of the Instrument.

Section 3 is a scope provision intended to ensure that the Instrument applies to the same contracts and instruments in all jurisdictions of Canada. Each jurisdiction has adopted a Product Determination Rule that excludes certain types of contracts and instruments from being derivatives for the purpose of the Instrument.

Section 7 provides that the requirements of the Instrument, other than the specific requirements listed in subsection 7(1), do not apply to a derivatives firm if it is dealing with or advising an eligible derivatives party that is not an individual, or an eligible derivatives party that is an individual that has waived these protections in writing (collectively, a **specified eligible derivatives party**).

[5] See, for example, the definition of "eligible contract participant" under the U.S. *Commodity Exchange Act* and the *Securities Exchange Act of 1934* applicable to CFTC and SEC swap dealers and major swap participants, the definition of "qualified party" in British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*, the definition of "qualified party" in Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*, the definition of "accredited counterparty" in section 3 of the Quebec *Derivatives Act*, the definition of "qualified party" in New Brunswick Local Rule 91-501 *Derivatives*, the definition of "qualified party" in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives* and the definition of "qualified party" in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*.

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When a derivatives firm is dealing with or advising a specified eligible derivatives party, the derivatives firm will only be subject to the following requirements of the Instrument:

(a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];

(b) Sections 24 [*Interaction with NI 94-102*] and 25 [*Segregating derivatives party assets*] of Part 4 [*Derivatives party accounts*];

(c) Subsection 29(1) [*Content and delivery of transaction confirmations*] of Part 4 [*Derivatives party accounts*]; and

(d) Part 5 [*Compliance and recordkeeping*].

A derivatives firm and a specified eligible derivatives party may choose to incorporate additional protections in the contracts that govern their relationship and their derivatives trading activities. However, the CSA are of the view that, in the case of a derivatives firm dealing with or advising a specified eligible derivatives party these protections should not be required but rather should be a matter of contract for the parties.

Despite the foregoing, section 7 does not limit the requirements that apply to a derivatives firm acting as an adviser in respect of a managed account of an eligible derivatives party.

We have included specific questions about the differential treatment of derivatives parties and specified eligible derivatives parties in the Comments section.

We have also included a table that compares the approach in the Instrument with the approach under NI 31-103 in Appendix B.

Part 3 – Dealing with or advising derivatives parties

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Division 1 of Part 3 sets out the fundamental business conduct obligations that the CSA have recommended should apply to all derivatives firms when dealing with or advising derivatives parties, including eligible derivatives parties, namely

- fair dealing,
- responding to conflicts of interest, and
- general (or “gatekeeper”) know-your-derivatives party obligations.

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Fair dealing

The fair dealing obligation proposed in section 8 of this Instrument is consistent with international practice and is in line with the standards set by NI 31-103 while keeping in mind the differences between derivatives and securities markets. The CSA believe that the fair dealing obligation in section 8, as a principles-based obligation, should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations; the expectation is that it will be applied differently depending on the sophistication of the market participant.

Identifying and responding to conflicts of interest

Section 9 of the Instrument contains obligations to identify and respond to conflicts of interest. This obligation applies when dealing with or advising market participants of all levels of sophistication. It is a principles-based obligation, which should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations. Furthermore, it is expected that in responding to any conflict of interest, the derivatives party will consider the fair dealing obligation in Part 3 as well as any other standard of care that may apply when dealing with or advising a derivatives party.

General (or "gatekeeper") know-your-derivatives party obligations

Section 10 of the Instrument sets out the general "gatekeeper" know-your-derivatives party (**KYDP**) obligations. These obligations include requirements to: verify the identity of a derivatives party, verify that the derivatives party is an eligible derivatives party, determine if the derivatives party is an insider of a reporting issuer, and comply with anti-money-laundering and terrorist financing obligations.

We would anticipate that many derivatives firms, including Canadian financial institutions, will already have policies and procedures in place to address these obligations and that section 10 should not result in any significant new obligations for these entities.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

These obligations are intended to protect less sophisticated market participants. These include but are not limited to:

Derivatives-party-specific needs and objectives

Section 11 sets out the obligation on a derivatives firm to obtain information about a derivatives party's specific investment needs and objectives in order for the derivatives firm to meet its suitability obligations under section 12 and to assess a transaction under subsection 19(1).
Information on a derivatives party's specific needs and objectives (sometimes referred to as

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"client-specific KYC information") forms the basis for determining whether transactions in derivatives are suitable for a derivatives party or the terms of the transaction are the most advantageous. The obligations in section 11 require a derivatives firm to take reasonable steps to obtain and periodically update information about its derivatives parties.

Suitability

Section 12 requires a derivatives firm to take reasonable steps to ensure that a proposed transaction is suitable for a derivatives party before making a recommendation or accepting instructions from the derivatives party to transact in a derivative.

Disclosure regarding the use of borrowed money or leverage

Section 16 requires a derivatives firm to provide a risk disclosure to a derivatives party before a transaction takes place, which explains that the leverage inherent in derivatives may require the derivatives party to deposit additional funds if the value of the derivative declines and that borrowing money or using leverage to fund a derivatives transaction carries additional risk.

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH CERTAIN DERIVATIVES PARTIES

The obligations in Division 3 focus on restricting certain business activities when dealing with less sophisticated derivatives parties. These obligations relate to tied selling and fair terms and pricing. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Tied selling

Section 18 prohibits a derivatives firm from engaging in certain sales practices that would pressure or require a derivatives party to obtain a product or service as a condition of obtaining other products or services from the derivatives firm. An example of tied selling would be offering a loan on the condition that the derivatives party purchase another product or service, such as a swap to hedge the loan from the derivatives firm or one of its affiliates.

As explained in the CP, section 18 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain derivatives parties.

Fair terms and pricing

Subsection 19(1) imposes an obligation on derivatives firms to implement policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available when acting as agent for a derivatives party. Subsection 19(2) requires derivatives dealers, when transacting with a derivatives party as principal to make a reasonable effort to provide a price that is fair and reasonable taking into account all relevant factors.

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Part 4 – Derivatives Party Accounts

DIVISION 1 - DISCLOSURE TO DERIVATIVES PARTIES

The CSA believe that less sophisticated derivatives parties, or those individuals who would like a higher level of protection, need more detailed information concerning their transactions and their accounts. Below are some of the requirements designed to keep derivatives parties informed. The obligations in this Division do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Section 20 requires a derivatives firm to provide a derivatives party with all information that the derivatives party needs to understand not only their relationship with the derivatives firm but also the products and services that the derivatives firm will or may provide and the fees or other charges that the derivatives party may be required to pay.

Subsection 21(1) sets out the obligation for a derivatives firm to provide a derivatives party with disclosure relating to the type of derivative that is reasonably designed to allow the derivatives party to assess the material risks of transacting in the derivative. This includes the derivatives party's potential exposure and the material characteristics of the derivative which include the material economic terms and the rights and obligations of the counterparties to the type of derivative.

In addition, subsection 21(2) establishes obligations, before transacting a specific derivative, to advise the derivatives party about material risks in relation to the specific derivative that are materially different than the risks disclosed under subsection 21(1) and, if applicable, the price of the derivative to be transacted and the most recent valuation.

Further to these obligations, section 22 requires a derivatives firm to provide a derivatives party with daily valuation of the derivatives that it has transacted with or on behalf of that derivatives party.

DIVISION 2 - DERIVATIVES PARTY ASSETS

Division 2 sets out certain requirements related to segregation and holding of derivatives party assets held by a derivatives firm, as well as restrictions on the use and investment of those assets.

The obligations in this Division, other than section 24 and section 25, do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

DIVISION 3 - REPORTING TO DERIVATIVES PARTIES

Division 3 sets out obligations of derivatives firms to provide certain reports to derivatives parties.

Section 29 provides that a derivatives firm must provide a confirmation of the key elements of a derivatives transaction. The contents of this confirmation are set out in subsection 29(2).

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Section 30 sets out the obligations of a derivatives firm to provide monthly statements to derivatives parties. Subsection 30(2) describes the information that must be provided in the monthly statement.

The obligations in this Division, other than the fundamental transaction confirmation requirement in subsection 29(1), do not apply if a derivatives firm is dealing with or advising a specified eligible derivatives party.

Part 5 - Compliance and recordkeeping

DIVISION 1 - COMPLIANCE

Section 32 provides that a derivatives firm must have policies and procedures that establish a system of controls to assure that, with respect to transacting or advising on derivatives, the firms and individuals acting on its behalf comply with applicable laws, to manage risk and to ensure that individuals have the necessary training and expertise.

Section 33 imposes certain supervisory, management, and reporting obligations on "senior derivatives managers". These requirements are intended to create accountability at the senior management level. The CSA are monitoring international regulatory initiatives[6] designed to ensure that senior managers bear responsibility for the effective and efficient management of their business units. A senior derivatives manager is an individual that is responsible for the derivatives activities of a particular business unit (e.g., the individual responsible for, or head of, interest rate trading or the "rates desk" at a derivatives firm). Senior derivatives managers must supervise compliance activities, promote compliance, and take steps to prevent and respond to non-compliance. At least annually, senior derivatives managers must also report to the firm's board of directors, either to certify that the business unit is in material compliance with all applicable securities legislation, or to specify circumstances of material non-compliance.

Section 34 sets out the requirement of a derivatives firm to respond to material non-compliance, and in certain circumstances to report material non-compliance to the regulator or securities regulatory authority.

Part 6 - Exemptions

DIVISION 1 - EXEMPTIONS FROM THE INSTRUMENT

Section 38 provides that persons or companies that are registered under securities legislation, in Canada or a foreign jurisdiction, do not qualify for the exemption in section 39.

[6] See for example https://www.fca.org.uk/firms/senior-managers-certification-regime and http://www.sfc.hk/web/EN/faqs/intermediaries/licensing/manager-in-charge-regime.html

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Section 39 provides that derivatives end-users (e.g., entities that trade derivatives for their own account for commercial purposes) are exempt from the Instrument provided they do not do any of the following:

- solicit or otherwise transact in a derivative with, for or on behalf of a person or company that is not an eligible derivatives party;
- advise persons or companies in respect of transactions in derivatives, if the person or company is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 43;
- regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;
- regularly facilitate or otherwise intermediate transactions in derivatives for another person or company;
- facilitate the clearing of a transaction in a derivative through the facilities of a clearing agency for a third-party, other than an affiliated entity.

DIVISION 2 AND DIVISION 3 - EXEMPTIONS FROM SPECIFIC REQUIREMENTS OF THE INSTRUMENT

Foreign derivatives dealers and foreign derivatives advisers

These Divisions provide, under certain conditions, an exemption from requirements in the Instrument for foreign derivatives dealers and foreign derivatives advisers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Proposed Instrument.

These exemptions apply to the provisions of the Instrument where the derivatives dealer or derivatives adviser is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix A and Appendix D of the Instrument opposite the name of the foreign jurisdiction. The jurisdictions specified in Appendices A and D will be determined on a jurisdiction-by-jurisdiction basis, and based on a review of the laws and regulatory framework of the jurisdiction.

Note that as of the time of this publication for comment, the equivalence analysis required to populate Appendices A and D of the Instrument has not been completed.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

Division 3 provides an exemption for persons and companies that provide general advice in relation to derivatives, where the advice is not tailored to the needs of the person or company receiving the advice (e.g., analysis published in mass media), and the person or company discloses all financial or other interests in relation to the advice.

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Anticipated Costs and Benefits

The CSA have developed the Proposed Instrument to help protect investors and counterparties, reduce risk, improve transparency and accountability and promote responsible business conduct in the OTC derivatives markets.

We are proposing an investor protection regime for Canadian OTC derivatives parties that is equivalent to the protections offered in major international markets and also targets misconduct that could impact the Canadian market.

There will be compliance costs for derivatives firms that may increase the cost of trading or receiving advice for market participants. In the CSA's view, the compliance costs to market participants are proportionate to the benefits to the Canadian market of implementing the Proposed Instrument. The major benefits and costs of the Proposed Instrument are described below.

(a) Benefits

The Proposed Instrument will protect participants in the Canadian OTC derivatives market by reducing the likelihood of suffering loss through inappropriate transactions, inappropriate sale of derivatives and market misconduct. The Proposed Instrument offers protections not only to retail market participants but also large market participants whose derivatives losses could impact their business operations and potentially the Canadian economy more broadly. The Proposed Instrument fills a regulatory gap in the Canadian OTC derivatives market for certain derivatives firms that are not subject to business conduct regulation and oversight. It is intended to foster confidence in the Canadian derivatives market by creating a regime that meets international standards and is equivalent to the regimes in major trading jurisdictions. Currently, OTC derivatives are regulated differently across Canadian jurisdictions, and there is inconsistency in regulation of business conduct in OTC derivatives markets. The Proposed Instrument aims to reduce compliance costs for derivatives firms by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market.

(b) Costs

Generally, any increased costs resulting from compliance with the Proposed Instrument are expected to arise from analysing the requirements put forth and establishing policies and procedures for compliance. Any costs associated with complying with the Proposed Instrument are expected to be borne by derivatives firms and in certain circumstances may be passed on to derivatives parties. There is also a possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Instrument, which would reduce Canadian derivatives parties' options for derivatives services. However the Proposed Instrument contemplates an exemption for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent exemptions under foreign laws. This exemption could significantly reduce compliance costs associated with the Proposed Instrument for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

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(c) Conclusion

Protection of derivatives parties and the integrity of the Canadian derivatives market are the fundamental principles of the Proposed Instrument. The CSA are of the view that the impact of the Proposed Instrument, tailored for the OTC derivatives market, including anticipated compliance costs for derivatives firms, is proportional to the benefits sought. The Proposed Instrument aims to provide a level of protection similar to that offered to derivatives parties in other jurisdictions with significant OTC derivatives markets. To achieve a balance of interests, the Proposed Instrument is designed to promote a safer environment in the Canadian derivatives market by delivering a high level of protection to customers transacting in OTC derivatives and also facilitate a flexible and competitive market for derivatives firms to operate in.

Contents of Annexes

The following annexes form part of this CSA Notice:

- Annex I – Proposed National Instrument 93-101 Derivatives: Business Conduct
- Annex II – Proposed Companion Policy 93-101 Derivatives: Business Conduct
- Annex III – Local Matters

Comments

In addition to your comments on all aspects of the Proposed Instrument, the CSA also seek specific feedback on the following questions:

1) Definition of "eligible derivatives party"

As currently drafted, the definition of "eligible derivatives party" is generally similar to the definition of "permitted client" in NI 31-103, with a few modifications to reflect the different nature of derivatives markets and participants.

Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

2) Alternative definition of "eligible derivatives party"

In the CSA Consultation Paper 33-404, it was put forth that certain proposed targeted reforms relating to the client-registrant relationship be tailored in their application to "institutional clients." Proposed targeted reforms relating to suitability and KYC requirements would, for instance, not apply to registrants dealing with an institutional client.[7]

[7] See (2016), 39 OSCB 3964 et seq.

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The CSA Consultation Paper 33-404 proposed a definition of "institutional client"[8] which is generally similar to the definition of a "permitted client" in section 1.1 of NI 31-103. However, in comparison to the definition of "permitted client" in NI 31-103 (which refers in paragraph (o) to individuals that beneficially own a specified threshold of financial assets), the definition of "institutional client" in the Consultation Paper did not include individuals. Moreover, in comparison to paragraph (q) of the definition of "permitted client" (which refers to "a person or company, other than an individual or an investment fund, that has net assets of at least $25 million as shown on its most recently prepared financial statements"), the following branch of the definition of "institutional client" proposed in the CSA Consultation Paper 33-404 would establish a higher financial threshold for non-individual entities:

> (x) *any other person or company, other than an individual, with financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $100 million.*

Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

3) <u>Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"</u>

Clauses (m) and (n) of the definition of "eligible derivatives party" provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, "the characteristics of the derivatives to be transacted". The corresponding section of the companion policy notes that "some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type".

If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?

Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

4) <u>Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties</u>

Do you agree with the two-tiered approach to investor/customer protection in the Instrument? Are there additional requirements that a derivatives firm should be subject to even when dealing

[8] For the proposed definition of "institutional client, see (2016), 39 OSCB 3978 et seq.

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with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

5) Business trigger guidance

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

> *Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if "the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party".

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

6) Fair Dealing

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

7) Fair terms and pricing

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

8) Derivatives Party Assets

National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division

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2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party.

Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

9) Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

10) Senior derivatives managers

Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on "senior derivatives managers", and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

11) Exemptions

Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

Please provide your comments in writing by **September 1, 2017.**

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the *Autorité des marchés financiers* at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

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Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Please send your comments **only** to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax: 514-864-6381
consultation-en-cours@lautorite.qc.ca

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Questions

Please refer your questions to any of:

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Co-Chair, CSA Derivatives Committee
Senior Director, Derivatives Oversight
Autorité des marchés financiers
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Securities Division
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of Saskatchewan
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liz.kutarna@gov.sk.ca

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Appendix A

Comparison of protections that do not apply to, or may be waived by, "eligible derivatives parties" under Proposed NI 93-101 *Derivatives: Business Conduct* and "permitted clients" under NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

Certain requirements in the Proposed Instrument are similar to existing market conduct requirements applicable to registered dealers and advisers under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) but have been modified to reflect the different nature of derivatives markets.

The extent to which obligations do not apply, or apply unless waived, when dealing with or advising an eligible derivatives party is set out in the following chart:

Obligation	Approach under NI 31-103	Approach under NI 93-101
Fair dealing[9]	Applies in respect of all clients	Applies in respect of all derivatives parties (s. 8)
Identifying and responding to conflicts of interest	Applies in respect of all clients (s. 13.4) However, client relationship disclosure obligations in relation to conflicts of interest do not apply in respect of a permitted client that is not an individual (s. 14.2(6))	Applies in respect of all derivatives parties (s. 9) However, relationship disclosure obligations in Part 4 in relation to conflicts of interest do not apply in respect of • an EDP that is not an individual • an EDP that is an individual that has waived this disclosure

[9] See section 2.1 of OSC Rule 31-505 *Conditions of Registration*; section 14 of the Securities Rules, B.C. Reg. 194/97 **[B.C. Regulations]** under the *Securities Act* (British Columbia), R.S.B.C. 1996, c. 418 **[B.C. Act]**; section 75.2 of the *Securities Act* (Alberta) R.S.A. 2000, c.S-4 **[Alberta Act]**; section 33.1 of *The Securities Act, 1988* (Saskatchewan), S.S. 1988-89, c. S-42.2 **[Saskatchewan Act]**; subsection 154.2(3) of *The Securities Act* (Manitoba) C.C.S.M. c. S50 **[Manitoba Act]**; section 65 of the *Derivatives Act* (Québec), R.S.Q., c. 14.01 **[Québec Act]**; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 **[N.S. Act]**; subsection 54(1) of the *Securities Act* (New Brunswick) S.N.B. 2004, c. S-5.5 **[N.B. Act]**; section 90 of the *Securities Act* (Prince Edward Island), R.S.P.E.I. 1988, c. S-3.1 **[P.E.I. Act]**; subsection 26.2(1) of the *Securities Act* (Newfoundland and Labrador), R.S.N.L.1990, c. S-13 **[Newfoundland Act]**; section 90 of the *Securities Act* (Nunavut), S.Nu. 2008, c. 12 **[Nunavut Act]**; section 90 of the *Securities Act* (Northwest Territories), S.N.W.T. 2008, c. 10 **[N.W.T. Act]**; and section 90 of the *Securities Act* (Yukon), S.Y. 2007, c. 16 **[Yukon Act]**.

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Gatekeeper KYC (AML, etc.)	Applies in respect of all clients (s. 13.2) However, this does not apply if the client is a registered firm, Canadian financial institution or Schedule III bank (s. 13.2(5))	Applies in respect of all derivatives parties (s. 10) However, this does not apply if the derivatives party is a registered firm or a Canadian financial institution (including a Schedule III bank)
Client-specific KYC (investment needs and objectives, etc.) Suitability	Applies in respect of all clients (ss. 13.2(2)(c) and 13.3) May be waived in writing by a permitted client (including an individual permitted client) if registrant does not act as an adviser in respect of a managed account for the client (ss. 13.2(6) and 13.3(4))	Applies in respect of all derivatives parties other than • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation (ss. 7, 11 and 12)
Miscellaneous other obligations	Do not apply to a permitted client • Disclosure when recommending the use of borrowed money – s. 13.13(2) • When the firm has a relationship with a financial institution – s. 14.4(3)	Apply in respect of all derivatives parties other than • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation (ss. 7 and 16)
Miscellaneous other obligations	Do not apply to a permitted client that is not an individual • Dispute resolution service – s. 13.16(8) • Relationship disclosure information – s. 14.2(6) • Pre-trade disclosure of charges – s. 14.2.1(2), • Restriction on self-custody and qualified custodian requirement – s. 14.5.2 • Additional statements – s. 14.14.1 • Security position cost information – s. 14.14.2 • Report on charges and other compensation – s. 14.17 • Investment performance report – s. 14.18	Apply in respect of all derivatives parties other than • an EDP that is not an individual • an EDP that is an individual that has waived in writing this obligation (See s. 7 and Part 4)

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Appendix B

Application of business conduct requirements

Regulatory Requirement	Derivatives firms dealing only with EDPs	Derivatives firms dealing with non-EDPs	Derivatives advisers acting for managed account
General obligations toward all (Part 3 Div 1) • Fair dealing • Conflict of interest management • General/gatekeeper know-your-derivatives party	•	•	•
Additional obligations and restrictions (Part 3 Div 2–3) • Derivatives-party-specific know-your-derivatives party • Product suitability • Permitted referral arrangements • Leverage/borrowing disclosure • Complaint handling • Prohibition on tied selling • Fair terms and pricing		•	•
Client and counterparty accounts (Part 4) • Relationship disclosure • Pre-trade disclosures re. risk, product, price, and compensation • Report daily valuations • Notice by non-resident registrants • Holding of assets[10] • Use and investment of assets • Transaction confirmations[11] • Monthly statements		•	•
Compliance and recordkeeping (Part 5) • Compliance and risk management systems • Senior manager certification • Client/counterparty agreement • Recordkeeping	•	•	•

[10] A basic segregation requirement applies in all circumstances, but most of the asset requirements only apply in the non-EDP context.

[11] A basic transaction confirmation requirement applies in all circumstances, but the more detailed requirement applies only in the non-EDP context.

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ANNEX I

PROPOSED NATIONAL INSTRUMENT 93-101
DERIVATIVES: BUSINESS CONDUCT

PART 1
DEFINITIONS AND INTERPRETATION

Definitions and interpretation

1. **(1)** In this Instrument

"Canadian financial institution" means

(a) an association governed by the *Cooperative Credit Associations Act* (Canada) or a central cooperative credit society for which an order has been made under section 473(1) of that Act, or

(b) a bank, loan corporation, trust company, trust corporation, insurance company, treasury branch, credit union, caisse populaire, financial services cooperative, or league that, in each case, is authorized by an enactment of Canada or a jurisdiction of Canada to carry on business in Canada or a jurisdiction of Canada;

"derivatives adviser" means

(a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others as to transacting in derivatives, and

(b) any other person or company required to be registered as a derivatives adviser under the securities legislation of a jurisdiction of Canada;

"derivatives dealer" means

(a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in derivatives as principal or agent, and

(b) any other person or company required to be registered as a derivatives dealer under the securities legislation of a jurisdiction of Canada;

"derivatives firm" means a derivatives dealer or a derivatives adviser, as applicable;

"derivatives party" means

(a) in the case of a derivatives dealer,

(i) a person or company for which the derivatives dealer acts or proposes to act as an agent in relation to a transaction in a derivative, or

(ii) a person or company that is or is proposed to be a party to a derivative where the derivatives dealer is the counterparty, and

(b) in the case of a derivatives adviser, a person or company to which the adviser provides or proposes to provide advice in relation to derivatives;

“derivatives party assets” means any asset received or held by a derivatives firm, for or on behalf of a derivatives party;

“eligible derivatives party” means any of the following:

(a) a Canadian financial institution;

(b) the Business Development Bank of Canada incorporated under the *Business Development Bank of Canada Act* (Canada);

(c) a subsidiary of a person or company referred to in paragraph (a) or (b), if the person or company owns all of the voting securities of the subsidiary, except the voting securities required by law to be owned by directors of the subsidiary;

(d) a person or company registered under the securities legislation of a jurisdiction of Canada as at least one of the following:

(i) a derivatives dealer;

(ii) a derivatives adviser;

(iii) an adviser;

(iv) an investment dealer;

(e) a pension fund that is regulated by either the federal Office of the Superintendent of Financial Institutions or a pension commission or similar regulatory authority of a jurisdiction of Canada or a wholly-owned subsidiary of such a pension fund;

(f) an entity organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (e);

(g) the Government of Canada or a jurisdiction of Canada, or any Crown corporation, agency or wholly-owned entity of the Government of Canada or a jurisdiction of Canada;

(h) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any agency of that government;

(i) a municipality, public board or commission in Canada and a metropolitan community, school board, the Comité de gestion de la taxe scolaire de l’île de Montréal or an intermunicipal management board in Québec;

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(j) a trust company or trust corporation registered or authorized to carry on business under the *Trust and Loan Companies Act* (Canada) or under comparable legislation in a jurisdiction of Canada or a foreign jurisdiction, acting on behalf of a managed derivatives account managed by the trust company or trust corporation, as the case may be;

(k) a person or company acting on behalf of a managed account that is managed by the person or company, if the person or company is registered or authorized to carry on business as an adviser or a derivatives adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction;

(l) an investment fund that is advised by an adviser registered or exempted from registration under securities or commodity futures legislation in Canada;

(m) a person or company, other than an individual,

(i) that has represented in writing that it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives, the suitability of the derivatives for that person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf, and

(ii) that has net assets of at least $25 million as shown on its most recently prepared financial statements;

(n) an individual

(i) who has represented in writing that he or she has the requisite knowledge and experience to evaluate the information provided to the individual about derivatives, the suitability of the derivatives for that individual, and the characteristics of the derivatives to be transacted on the individual's behalf, and

(ii) that beneficially owns financial assets, as defined in section 1.1 of National Instrument 45-106 *Prospectus Exemptions*, that have an aggregate realizable value before tax but net of any related liabilities of at least $5 million;

“investment dealer” means a person or company registered as an investment dealer under the securities legislation of a jurisdiction of Canada;

“managed account” means an account of a derivatives party for which a person or company makes the trading decisions if that person or company has discretion to trade securities for the account or transact in a derivative for the account without requiring the derivatives party’s express consent to the transaction;

“permitted depository” means a person or company that is any of the following:

(a) a Canadian financial institution;

(b) a regulated clearing agency;

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(c) the central bank of Canada or of a permitted jurisdiction;

(d) in Québec, a person recognized or exempted from recognition as a central securities depository under the *Securities Act* (Québec);

(e) a person or company

(i) whose head office or principal place of business is in a permitted jurisdiction,

(ii) that is a banking institution or trust company of a permitted jurisdiction, and

(iii) that has shareholders' equity, as reported in its most recent audited financial statements, of not less than the equivalent of $100 000 000;

(f) with respect to derivatives party assets that it receives from a derivatives party, a derivatives dealer;

"permitted investment" means cash, or a security or other financial instrument with minimal market and credit risk that is capable of being liquidated rapidly with minimal adverse price effect;

"permitted jurisdiction" means a foreign jurisdiction that is any of the following:

(a) a country where the head office or principal place of business of a Schedule III bank is located, and a political subdivision of that country;

(b) if a derivatives party has provided express written consent to the derivatives dealer entering into a derivative in a foreign currency, the country of origin of the foreign currency used to denominate the rights and obligations under the derivative entered into by, for or on behalf of the derivatives party, and a political subdivision of that country;

"referral arrangement" means any arrangement in which a derivatives firm agrees to pay or receive a referral fee;

"referral fee" means any form of compensation, direct or indirect, paid for the referral of a derivatives party to or from a derivatives firm;

"registered derivatives firm" means a derivatives dealer or a derivatives adviser that is registered under securities legislation of a jurisdiction in Canada;

"registered firm" means a registered derivatives firm or a registered firm, as that term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

"regulated clearing agency" has the meaning ascribed to that term in National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*;

"Schedule III bank" means an authorised foreign bank named in Schedule III of the *Bank Act* (Canada);

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"segregate" means to separately hold or separately account for a derivatives party's positions or collateral;

"transaction" means any of the following:

(a) entering into a derivative or making a material amendment to, terminating, assigning, selling or otherwise acquiring or disposing of a derivative;

(b) the novation of a derivative, other than a novation with a clearing agency;

"valuation" means the current value of a derivative.

(2) In this Instrument, "adviser" includes

(a) in Manitoba, an "adviser" as defined in the *Commodity Futures Act* (Manitoba),

(b) in Ontario, an "adviser" as defined in the *Commodity Futures Act* (Ontario), and

(c) in Québec, an "adviser" as defined in the *Securities Act* (Québec).

(3) In this Instrument, a person or company is an affiliated entity of another person or company if one of them controls the other or each of them is controlled by the same person or company.

(4) In this Instrument, a person or company (the first party) is considered to control another person or company (the second party) if any of the following apply:

(a) the first party beneficially owns or directly or indirectly exercises control or direction over securities of the second party carrying votes which, if exercised, would entitle the first party to elect a majority of the directors of the second party unless the first party holds the voting securities only to secure an obligation;

(b) the second party is a partnership, other than a limited partnership, and the first party holds more than 50% of the interests of the partnership;

(c) the second party is a limited partnership and the general partner of the limited partnership is the first party;

(d) the second party is a trust and a trustee of the trust is the first party.

(5) In this Instrument, a person or company is a subsidiary of another person or company if

(a) it is controlled by

(i) that other,

(ii) that other and one or more persons or companies, each of which is controlled by that other, or

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(iii) two or more persons or companies, each of which is controlled by that other, or

(b) it is a subsidiary of a person or company that is that other's subsidiary.

(6) In this Instrument, in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, "derivative" means a "specified derivative" as defined in Multilateral Instrument 91-101 *Derivatives: Product Determination*.

PART 2
APPLICATION

Application to registered and unregistered derivatives firms

2. This Instrument applies to a derivatives firm, whether or not it is a registered derivatives firm.

Scope of Instrument

3. This Instrument applies to

(a) in Manitoba,

(i) a derivative other than a contract or instrument that, for any purpose, is prescribed by any of sections 2, 4 and 5 of Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a derivative, and

(ii) a derivative that is otherwise a security and that, for any purpose, is prescribed by section 3 of Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a security,

(b) in Ontario,

(i) a derivative other than a contract or instrument that, for any purpose, is prescribed by any of sections 2, 4 and 5 of Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a derivative, and

(ii) a derivative that is otherwise a security and that, for any purpose, is prescribed by section 3 of Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination* not to be a security, and

(c) in Québec, a derivative specified in section 1.2 of *Regulation 91-506 respecting Derivatives Determination*, other than a contract or instrument specified in section 2 of that regulation.

In each other local jurisdiction, this Instrument applies to a derivative as defined in subsection 1(6) of this Instrument. The text boxes in this Instrument do not form part of this Instrument and have no official status.

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Affiliated entities

4. This Instrument does not apply to a person or company in respect of dealing with or advising an affiliated entity of the person or company.

Regulated clearing agencies

5. This Instrument does not apply to a regulated clearing agency.

Governments, central banks and international organizations

6. This Instrument does not apply to any of the following:

(a) the government of Canada, the government of a jurisdiction of Canada or the government of a foreign jurisdiction;

(b) the Bank of Canada or a central bank of a foreign jurisdiction;

(c) the Bank for International Settlements;

(d) the International Monetary Fund.

Requirements that apply when dealing with or advising an eligible derivatives party

7. (1) The requirements of this Instrument, other than the following requirements, do not apply to a derivatives firm in respect of a derivatives party that is an eligible derivatives party and that is not an individual:

(a) Division 1 [*General obligations towards all derivatives parties*] of Part 3 [*Dealing with or advising derivatives parties*];

(b) Sections 24 [*Interaction with NI 94-102*] and 25 [*Segregating derivatives party assets*];

(c) Subsection 29(1) [*Content and delivery of transaction confirmations*]; and

(d) Part 5 [*Compliance and recordkeeping*].

(2) The requirements of this Instrument, other than the requirements specified in subsection (1), do not apply to a derivatives firm in respect of a derivatives party who is an eligible derivatives party and who is an individual if

(a) the individual has waived in writing the protections under the Instrument, other than as specified in subsection (1), and

(b) the individual has signed the waiver no earlier than 365 days before the derivatives firm transacts with or provides advice to the individual.

(3) Despite subsections (1) and (2), the requirements of the Instrument apply to a derivatives firm acting as an adviser in respect of a managed account of an eligible derivatives party.

PART 3
DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Fair dealing

8. **(1)** A derivatives firm must deal fairly, honestly and in good faith with a derivatives party.

(2) An individual acting on behalf of a derivatives firm must deal fairly, honestly and in good faith with a derivatives party.

(3) A derivatives adviser must allocate transaction opportunities fairly among its derivatives parties.

Conflicts of interest

9. **(1)** A derivatives firm must establish, maintain and apply policies and procedures reasonably designed to identify existing material conflicts of interest, and material conflicts of interest that the derivatives firm in its reasonable opinion would expect to arise, between the derivatives firm, including each individual acting on behalf of the derivatives firm, and a derivatives party.

(2) A derivatives firm must respond to an existing or potential conflict of interest identified under subsection (1).

(3) If a reasonable derivatives party would expect to be informed of a conflict of interest identified under subsection (1), the derivatives firm must disclose, in a timely manner, the nature and extent of the conflict of interest to the derivatives party whose interest conflicts with the interest identified.

Know your derivatives party

10. **(1)** For the purpose of paragraph 2(c) in Ontario, Nova Scotia and New Brunswick, "insider" has the meaning ascribed to that term in the *Securities Act* of these jurisdictions except that "reporting issuer", as it appears in the definition of "insider", is to be read as "reporting issuer or any other issuer whose securities are publicly traded".

(2) A derivatives firm must establish, maintain and apply reasonable policies and procedures to

(a) obtain such facts as are necessary to comply with applicable federal and provincial legislation relating to the verification of a derivatives party's identity,

(b) establish the identity of a derivatives party and, if the derivatives firm has cause for concern, make reasonable inquiries as to the reputation of the derivatives party,

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(c) if transacting with, for or on behalf of, or advising a derivatives party in connection with derivatives that have securities as an underlying interest, establish whether either of the following applies:

(i) the derivatives party is an insider of a reporting issuer or any other issuer whose securities are publicly traded,

(ii) the derivatives party would reasonably be expected to have access to material non-public information relating to any interest underlying the derivative, and

(d) if the derivatives firm will, as a result of its relationship with the derivatives party have any credit risk in relation to the derivatives party, establish the creditworthiness of the derivatives party.

(3) For the purpose of establishing the identity of a derivatives party that is a corporation, partnership or trust, each derivatives firm must establish both of the following:

(a) the nature of the derivatives party's business;

(b) the identity of any individual who meets either of the following:

(i) in the case of a corporation, is a beneficial owner of, or exercises direct or indirect control or direction over, more than 25% of the voting rights attached to the outstanding voting securities of the corporation;

(ii) in the case of a partnership or trust, exercises control over the affairs of the partnership or trust.

(4) A derivatives firm must take reasonable steps to keep the information required under this section current.

(5) This section does not apply if the derivatives party is a registered firm or a Canadian financial institution.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

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Derivatives-party-specific needs and objectives

11. A derivatives firm must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a derivatives party to transact in a derivative, or transact in a derivative for a derivatives party's managed account, it has sufficient information regarding all of the following to enable it to meet its obligations under section 12 [*Suitability*]:

(a) the derivatives party's needs and objectives with respect to its transacting in derivatives;

(b) the derivatives party's financial circumstances;

(c) the derivatives party's risk tolerance;

(d) if applicable, the nature of the derivatives party's business and the operational risks it wants to manage.

Suitability

12. (1) A derivatives firm must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a derivatives party to transact in a derivative, the transaction is suitable for the derivatives party.

(2) If a derivatives party instructs a derivatives firm to transact in a derivative and, in the derivatives firm's reasonable opinion, following the instruction would not be suitable for the derivatives party, the derivatives firm must inform the derivatives party in writing of the derivatives firm's opinion and must not transact in the derivative unless the derivatives party instructs the derivatives firm to proceed anyway.

Permitted referral arrangements

13. A derivatives firm, or an individual acting on behalf of a derivatives firm, must not participate in a referral arrangement with another person or company unless

(a) before a derivatives party is referred by or to the derivatives firm, the terms of the referral arrangement are set out in a written agreement between the derivatives firm and the person or company,

(b) the derivatives firm records all referral fees, and

(c) the derivatives firm or individual acting on behalf of the derivatives firm ensures that the information prescribed by section 15 [*Disclosing referral arrangements to a derivatives party*] is provided to the derivatives party in writing before the derivatives firm or individual receiving the referral either opens an account for the derivatives party or provides services to the derivatives party.

Verifying the qualifications of the person or company receiving the referral

14. A derivatives firm, or an individual acting on behalf of a derivatives firm, must not refer a derivatives party to another person or company unless the derivatives firm first takes reasonable

steps to verify and conclude that the person or company has the appropriate qualifications to provide the services, and, if applicable, is registered to provide those services.

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Disclosing referral arrangements to a derivatives party

15. (1) The written disclosure of the referral arrangement required by paragraph 13(c) [*Permitted referral arrangements*] must include all of the following:

(a) the name of each party to the agreement referred to in paragraph 13(a) [*Permitted referral arrangements*];

(b) the purpose and material terms of the agreement, including the nature of the services to be provided by each party;

(c) any conflicts of interest resulting from the relationship between the parties to the agreement and from any other element of the referral arrangement;

(d) the method of calculating the referral fee and, to the extent possible, the amount of the fee;

(e) the category of registration, or exemption from registration, of each derivatives firm and individual acting on behalf of the derivatives firm that is a party to the agreement with a description of the activities that the derivatives firm or individual is authorized to engage in under that category or exemption and, giving consideration to the nature of the referral, the activities that the derivatives firm or individual is not permitted to engage in;

(f) any other information that a reasonable derivatives party would consider important in evaluating the referral arrangement.

(2) If there is a change to the information set out in subsection (1), the derivatives firm must ensure that written disclosure of that change is provided to each derivatives party affected by the change as soon as possible and no later than the 30th day before the date on which a referral fee is next paid or received.

Disclosure regarding the use of borrowed money or leverage

16. (1) A derivatives firm must, before transacting in a derivative with or on behalf of a derivatives party, provide the derivatives party with a written statement that is substantially similar to the following:

"A characteristic of many derivatives is that you are only required to deposit funds that correspond to a portion of your total potential obligations when entering into the derivative. However, your profits or losses from the derivative are based on changes in the total value of the derivative. This means the leverage characteristic magnifies the profit or loss under a derivative, and losses can greatly exceed the amount of funds deposited. Your derivatives firm may require you to deposit additional funds to cover your obligations under a derivative as the value of the derivative changes. If you fail to deposit these funds, your derivatives firm may close out your position without warning. You should understand all of your obligations under a derivative, including your obligations where the value of the derivative declines.

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Using borrowed money to finance a derivatives transaction involves greater risk than using cash resources only. If you borrow money, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the derivative declines."

(2) Subsection (1) does not apply if the derivatives firm has provided the derivatives party with the statement described under subsection (1) no earlier than the 180th day before the date of the proposed transaction.

Handling complaints

17. A derivatives firm must document and, in a manner that a reasonable person would consider fair and effective, respond to each complaint made to the derivatives firm about any product or service offered by the derivatives firm or an individual acting on behalf of the derivatives firm.

> *The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7*

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH CERTAIN DERIVATIVES PARTIES

Tied Selling

18. (1) A derivatives firm must not impose undue pressure on or coerce a person or company to obtain a product or service from a particular person or company, including the derivatives firm or any of its affiliates, as a condition of obtaining another product or service from the derivatives firm.

(2) A derivatives firm must, before the derivatives firm first transacts in a derivative with or on behalf of the derivatives party or advises the derivatives party in respect of a derivative, disclose to a derivatives party the prohibition on coercive tied selling set out in subsection (1) in a statement in writing.

Fair terms and pricing

19. (1) A derivatives firm that acts as agent for a derivatives party in connection with a transaction in a derivative must establish, maintain and apply written policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available when acting as agent for a derivatives party.

(2) When transacting in a derivative with a derivatives party, as principal, a derivatives dealer, or an individual acting on behalf of the derivatives dealer, must make a reasonable effort to provide a price for the derivatives party that is fair and reasonable taking into consideration all relevant factors.

INCLUDES COMMENT LETTERS

PART 4
DERIVATIVES PARTY ACCOUNTS

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The obligations in this Division do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Relationship disclosure information

20. (1) A derivatives firm must deliver to a derivatives party all information that a reasonable person would consider important about the derivatives party's relationship with the derivatives firm and each individual acting on behalf of the derivatives firm that is providing derivatives-related services to the derivatives party.

(2) Without limiting subsection (1), the information delivered under that subsection must include all of the following:

(a) a description of the nature or type of the derivatives party's account;

(b) a general description of the products and services the derivatives firm offers;

(c) a general description of the types of risks that a derivatives party should consider when making a decision relating to derivatives;

(d) a description of the risks to a derivatives party of using borrowed money to finance a derivative;

(e) a description of the conflicts of interest that the derivatives firm is required to disclose to a derivatives party under securities legislation;

(f) disclosure of the fees or other charges the derivatives party might be required to pay related to the derivatives party's account;

(g) a general description of the types of transaction fees or other charges the derivatives party might be required to pay;

(h) a general description of any compensation paid to the derivatives firm by any other party in relation to the different types of products that a derivatives party may transact in through the derivatives firm;

(i) a description of the content and frequency of reporting for each account or portfolio of a derivatives party;

(j) disclosure of the derivatives firm's obligations if a derivatives party has a complaint contemplated under section 17 [*Handling complaints*];

INCLUDES COMMENT LETTERS

(k) a statement that the derivatives firm has an obligation to assess whether a derivative is suitable for a derivatives party prior to executing a transaction for the derivative or at any other time or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;

(l) the information a derivatives firm must collect about the derivatives party under section 10 [*Know your derivatives party*] and 11 [*Derivatives-party-specific needs and objectives*] or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;

(m) a general explanation of how performance benchmarks might be used to assess the performance of a derivatives party's derivatives and any options for benchmark information that might be made available to the derivatives party by the derivatives firm.

(3) A derivatives firm must deliver the information in subsection (1), if applicable, and subsection (2) to the derivatives party in writing, before the derivatives firm

(a) transacts in a derivative with or on behalf of the derivatives party, or

(b) advises the derivatives party in respect of a derivative.

(4) If there is a significant change in respect of the information delivered to a derivatives party under subsections (1) or (2), the derivatives firm must take reasonable steps to notify the derivatives party of the change in a timely manner and, if possible, before the derivatives firm next

(a) transacts in a derivative with or on behalf of the derivatives party, or

(b) advises the derivatives party in respect of a derivative.

(5) A derivatives firm must not impose any new fee or other charge in respect of an account of a derivatives party, or increase the amount of any fee or other charge in respect of an account of a derivatives party, unless written notice of the new or increased fee or charge is provided to the derivatives party at least 60 days before the date on which the imposition or increase becomes effective.

(6) Subsections (1), (2), (3) and (4) do not apply to a derivatives dealer in respect of a derivatives party for whom the derivatives dealer transacts in a derivatives only as directed by a derivatives adviser acting for the derivatives party.

(7) A derivatives dealer referred to in subsection (6) must deliver the information required under paragraphs (2)(a) and (e) to (j) to the derivatives party in writing before the derivatives dealer first transacts in a derivative for the derivatives party.

INCLUDES COMMENT LETTERS

Pre-transaction disclosure

21. (1) Before transacting in a type of derivative with or on behalf of a derivatives party for the first time, a derivatives dealer must deliver a document reasonably designed to allow the derivatives party to assess each of the following:

(a) the material risks of the type of derivative transacted, including an analysis of the derivatives party's potential exposure under the type of derivative;

(b) the material characteristics of the type of derivative, including the material economic terms and the rights and obligations of the counterparties to the type of derivative.

(2) Before transacting in a derivative with or on behalf of a derivatives party, a derivatives dealer must advise the derivatives party of all of the following:

(a) any material risks or material characteristics that are materially different from those described in the disclosure required under subsection (1);

(b) if applicable, the price of the derivative to be transacted and the most recent valuation;

(c) any compensation or other incentive payable by the derivatives party relating to the derivative or the transaction in the derivative.

Daily reporting

22. On each business day, a derivatives firm must make available to a derivatives party a valuation for each derivative that it has transacted with or on behalf of the derivatives party and with respect to which contractual obligations remain outstanding on that day.

Notice to derivatives parties by non-resident derivatives firms

23. A derivatives firm whose head office is not located in Canada must not transact in a derivative with a derivatives party in the local jurisdiction unless it has delivered to the derivatives party a statement in writing disclosing all of the following:

(a) the jurisdiction in Canada or the foreign jurisdiction in which the head office or the principal place of business of the derivatives firm is located;

(b) that all or substantially all of the assets of the derivatives firm may be situated outside the local jurisdiction;

(c) that there may be difficulty enforcing legal rights against the derivatives firm because of the above;

(d) the name and address of the agent for service of process of the derivatives firm in the local jurisdiction.

INCLUDES COMMENT LETTERS

DIVISION 2 – DERIVATIVES PARTY ASSETS

This Division, other than Sections 24 and 25, do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Interaction with NI 94-102

24. This Division does not apply to a derivatives firm in respect of derivatives party assets if the derivatives firm is subject to and complies with or is exempt from sections 3 through 8 of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* in respect of those derivatives party assets.

Segregating derivatives party assets

25. A derivatives firm that holds derivatives party assets must segregate those assets from the positions and property of other persons or companies including the positions and property of the derivatives firm.

Holding derivatives party assets

26. A derivatives firm must hold all of its derivatives party assets

(a) in one or more accounts at a permitted depository that are clearly identified as holding derivatives party assets, and

(b) in separate accounts from the property of all persons who are not a derivatives party of the derivatives firm.

Use of derivatives party assets

27. (1) A derivatives firm must not use or permit the use of derivatives party assets except in accordance with this section and section 28 [*Investment of derivatives party assets*].

(2) A derivatives firm must not use or permit the use of derivatives party assets except to do either of the following:

(a) margin, guarantee, secure, settle or adjust the obligations of the derivatives party;

(b) secure or extend the credit of the derivatives party.

(3) Other than with respect to derivatives party assets used in accordance with paragraph (2)(b), a derivatives firm must not create or permit to exist any lien or other encumbrance on the derivatives party assets unless the lien or other encumbrance secures an obligation in favour of the derivatives party.

INCLUDES COMMENT LETTERS

Investment of derivatives party assets

28. (1) A derivatives firm must not invest derivatives party assets except in accordance with subsections (2) and (3).

(2) Subject to subsection (3), a derivatives firm may

(a) invest derivatives party assets in a permitted investment, and

(b) use derivatives party assets to purchase a permitted investment pursuant to an agreement for resale or repurchase if all of the following apply:

(i) the agreement is in writing;

(ii) the term of the agreement is no more than one business day;

(iii) written confirmation specifying the terms of the agreement is delivered to the derivatives party immediately upon entering into the agreement;

(iv) the agreement is not entered into with an affiliated entity of the derivatives firm.

(3) A loss resulting from an investment or use of a derivatives party's derivatives party assets in accordance with subsection (1) or subsection (2) by the derivatives firm must be borne by the derivatives firm making the investment and not by the derivatives party.

DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

This Division, other than Subsection 29(1), do not apply if a derivatives firm is dealing with an eligible derivatives party that is not an individual or an eligible derivatives party who is an individual that has waived these protections – see section 7

Content and delivery of transaction confirmations

29. (1) A derivatives dealer that has transacted with, for or on behalf of a derivatives party must promptly deliver to the derivatives party or, if the derivatives party consents in writing, to a derivatives adviser acting for the derivatives party, a written confirmation of the transaction.

(2) If the derivatives dealer has transacted with, for or on behalf of a derivatives party that is not an eligible derivatives party, the written confirmation of the transaction must set out all of the following, if and as applicable:

(a) a description of the derivative;

(b) information sufficient to identify the agreement that governs the transaction;

(c) the notional value or amount, quantity or volume of the underlying asset of the derivative;

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(d) the number of units of the derivative;

(e) the total price paid for the derivative and the per unit price of the derivative;

(f) the commission, sales charge, service charge and any other amount charged in respect of the transaction;

(g) whether the derivatives dealer acted as principal or agent in relation to the derivative;

(h) the date and the name of the trading facility, if any, on which the transaction took place;

(i) the name of the individual acting on behalf of the derivatives firm, if any, that provided advice relating to the derivative or the transaction;

(j) the settlement date of the transaction;

(k) the name of the regulated clearing agency, if any, where the derivative was cleared.

(3) For the purpose of paragraph (2)(i), an individual acting on behalf of a derivatives firm may be identified by means of a code or symbol if the confirmation also contains a statement that the name of the individual will be provided to the derivatives party on request of the derivatives party.

(4) The confirmation required under this section must be delivered promptly following the date of the transaction.

Derivatives party statements

30. (1) A derivatives firm must deliver a statement to a derivatives party promptly after the end of each month if either of the following applies:

(a) within the month a derivative was transacted with, for or on behalf of the derivatives party;

(b) the derivatives party has an outstanding position resulting from a transaction where the derivatives firm acted as a derivatives dealer.

(2) A statement delivered under this section must include all of the following information for each transaction made with, for or on behalf of the derivatives party by the derivatives firm during the period covered by the statement, if and as applicable:

(a) the date of the transaction;

(b) a description of the derivative transaction;

(c) information sufficient to identify the agreement that governs the transaction;

(d) the number of units of the derivative transacted and the nature of the transaction;

(e) the total price paid for the derivative and the per unit price of the derivative.

(3) A statement delivered under this section must include all of the following information about the derivatives party's account or position as at the date of the statement, if and as applicable:

(a) a description of each outstanding derivative to which the derivatives party is a party;

(b) the valuation of each outstanding derivative to which the derivatives party is a party as at the statement date;

(c) the final valuation of each derivative to which the derivatives party is a party that expired or terminated during the period covered by the statement as at the expiry or termination date;

(d) a description of all derivatives party assets held by the derivatives firm as collateral;

(e) any cash balance in the account;

(f) a description of any other derivatives party asset held by the derivatives firm;

(g) the total market value of all cash, outstanding derivatives and other derivatives party assets in the account, other than assets held as collateral.

PART 5
COMPLIANCE AND RECORDKEEPING

DIVISION 1 – COMPLIANCE

Definitions

31. In this Division,

"senior derivatives manager" means, in respect of a derivatives business unit of a derivatives firm, the individual designated by the derivatives firm as responsible for directing the derivatives activities of that unit;

"derivatives business unit" means, in respect of a derivatives firm, an organizational unit that transacts in or provides advice in relation to a derivative, or a class of derivatives, on behalf of the derivatives firm.

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Policies and procedures

32. A derivatives firm must establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to

(a) provide reasonable assurance that the derivatives firm and each individual acting on its behalf in relation to its activities relating to transacting in or advising on derivatives complies with applicable securities legislation,

(b) manage the risks relating to its derivatives activities in accordance with prudent business practices, and

(c) ensure that individuals that perform an activity relating to transacting in or advising on derivatives have, on an ongoing basis, the experience, the education and the training that a reasonable person would consider necessary to perform that activity competently, including understanding the structure, features and risks of each derivatives that the individual transacts in or recommends.

Responsibilities of senior derivatives managers

33. (1) Each senior derivatives manager of a derivatives firm must do all of the following:

(a) supervise the activities conducted in his or her derivatives business unit that are directed towards ensuring compliance by the derivatives business unit, and each individual working in the derivatives business unit, with this Instrument, applicable securities legislation and the policies and procedures required under section 32 [*Policies and procedures*];

(b) with respect to the derivatives activities conducted in his or her derivatives business unit, promote compliance by the derivatives business unit, and each individual working in the derivatives business unit, with this Instrument, applicable securities legislation and the policies and procedures required under section 32 [*Policies and procedures*];

(c) take reasonable steps to prevent and respond to any non-compliance, with respect to the derivatives activities conducted in his or her derivatives business unit, with this Instrument, applicable securities legislation or the policies and procedures required under section 32 [*Policies and procedures*].

(**2**) At least once per calendar year, each senior derivatives manager of a derivatives firm must, with respect to the derivatives activities conducted in his or her derivatives business unit, submit a report to the derivatives firm's board of directors, or individuals acting in a similar capacity for the derivatives firm,

(a) certifying that the derivatives business unit is in material compliance with this Instrument, applicable securities legislation, and the policies and procedures required under section 32 [*Policies and procedures*], or

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(b) specifying all circumstances where the derivatives business unit is not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*].

Responsibility of derivatives firm to respond to material non-compliance

34. If a senior derivatives manager specifies circumstances under paragraph 33(2)(b) where a derivatives business unit is not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*], the derivatives firm must,

(a) respond to the specified non-compliance in a timely manner, and document its response, and

(b) report to the regulator or securities regulatory authority in a timely manner any circumstance where, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with this Instrument, applicable securities legislation, or the policies and procedures required under section 32 [*Policies and procedures*].

DIVISION 2 – RECORDKEEPING

Derivatives party agreement

35. (1) A derivatives firm must establish policies and procedures that are reasonably designed to ensure that the derivatives firm, before transacting in a derivative with or on behalf of a derivatives party, enters into an agreement with that derivatives party.

(2) The agreement referenced in subsection (1) must establish all of the material terms governing the relationship between the derivatives firm and the derivatives party including those relating to the rights and obligations of the derivatives firm and the derivatives party.

Records

36. A derivatives firm must keep complete records of all its derivatives, transactions and advising activities, including, as applicable, all of the following:

(a) general records of its derivatives business and activities conducted with derivatives parties, and compliance with applicable provisions of securities legislation, including

(i) records of derivatives party assets, and

(ii) evidence of the derivatives firm's compliance with internal policies and procedures;

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(b) for each derivative, records that demonstrate the existence and nature of the derivative, including

(i) records of communications with derivatives parties relating to transacting in derivatives,

(ii) documents provided to derivatives parties to confirm the derivative and their terms and each transaction relating to the derivative,

(iii) correspondence relating to the derivative and each transaction relating to the derivative, and

(iv) records made by staff relating to the derivative and transactions relating to the derivative, such as notes, memos or journals;

(c) for each derivative, records that provide for a complete and accurate reconstruction of the derivative and all transactions relating to the derivative, including

(i) records relating to pre-execution activity including all communications relating to quotes, solicitations, instructions, transactions and prices however they may be communicated,

(ii) reliable timing data for the execution of each transaction relating to the derivative, and

(iii) records relating to the execution of the transaction including

(A) information obtained to determine whether the counterparty qualifies as an eligible derivatives party,

(B) fees or commissions charged, and

(C) any other information relevant to the transaction;

(d) an itemized record of post-transaction processing and events, including

(i) data reported to a trade repository, including the time and date that the report is made,

(ii) transaction confirmations,

(iii) terminations of derivatives,

(iv) novations of derivatives,

(v) amendments to derivatives,

(vi) assignment of derivatives or rights under derivatives,

(vii) netting of derivatives, and

(viii) margining and collateralization.

Form, accessibility and retention of records

37. (1) A derivatives firm must keep a record that it is required to keep under this Part, and all supporting documentation,

(a) in a readily accessible and safe location and in a durable form,

(b) in the case of a record or supporting documentation that relates to a derivative, for a period of 7 years following the date on which the derivative expires or is terminated, and

(c) in any other case, for a period of 7 years following the date on which a derivatives party's last derivative expires or is terminated.

(2) Despite subsection (1), in Manitoba, with respect to a derivatives firm or a derivatives party located in Manitoba, the time period applicable to records and supporting documentation kept pursuant to subsection (1) is 8 years.

PART 6
EXEMPTIONS

DIVISION 1 – EXEMPTIONS FROM THIS INSTRUMENT

Limitation on the availability of exemptions in this Division

38. The exemptions in this Division are not available to a person or company if either of the following applies:

(a) the person or company is a registered firm in any jurisdiction in Canada;

(b) the person or company is registered under the securities, commodity futures or derivatives legislation of the foreign jurisdiction in which its head office or principal place of business is located in a category of registration that permits it to carry on the activities in that jurisdiction that registration as a derivatives dealer or derivatives adviser would permit it to carry on in the local jurisdiction.

Exemption for certain derivatives end-users

39. A person or company is exempt from the requirements of this Instrument if each of the following applies:

(a) the person or company does not solicit, or otherwise transact in a derivative with, for or on behalf of, a person or company that is not an eligible derivatives party;

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(b) the person or company does not, in respect of transactions in derivatives, advise other persons or companies that are not eligible derivatives parties, other than general advice that is provided in accordance with the conditions of section 43 [*Advising generally*];

(c) the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;

(d) the person or company does not regularly facilitate or otherwise intermediate transactions in derivatives for another person or company;

(e) the person or company does not facilitate the clearing of a transaction in a derivative through the facilities of a clearing agency for another person or company, other than for an affiliated entity.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Foreign derivatives dealers

40. (1) A derivatives dealer whose head office or principal place of business is in a foreign jurisdiction is exempt from this Instrument in respect of a transaction if

(a) the derivatives dealer does not solicit, or otherwise transact in a derivative with, for or on behalf of, a person or company in the local jurisdiction that is not an eligible derivatives party,

(b) the derivatives dealer is registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix A to conduct the derivatives activities in the foreign jurisdiction that it proposes to conduct with the derivatives party, and

(c) the derivatives dealer complies with the laws of the foreign jurisdiction applicable to the derivatives dealer set out in Appendix A relating to the activities being conducted.

(2) Despite subsection (1), a derivatives dealer relying on the exemption set out in that subsection must comply with the provisions of this Instrument set out in Appendix A opposite the name of the foreign jurisdiction in respect of the transaction.

(3) The exemption in subsection (1) is not available to a person or company in respect of a transaction in a derivative unless all of the following apply:

(a) the head office or principal place of business of the person or company is in the foreign jurisdiction in which it is registered, licensed or otherwise authorized;

(b) the person or company engages in the business of a derivatives dealer in the foreign jurisdiction in which its head office or principal place of business is located;

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(c) the person or company has delivered to the derivatives party a statement in writing disclosing all of the following:

(i) the foreign jurisdiction in which the person or company's head office or principal place of business is located;

(ii) that all or substantially all of the assets of the person or company may be situated outside of the local jurisdiction;

(iii) that there may be difficulty enforcing legal rights against the person or company because of the above;

(iv) the name and address of the agent for service of the person or company in the local jurisdiction;

(d) the person or company has submitted to the securities regulatory authority a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

(e) the person or company is not in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in the jurisdiction;

(f) the person or company undertakes to the securities regulatory authority to provide the securities regulatory authority with prompt access to its books and records upon request.

(4) A person or company that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or, in Québec, the securities regulatory authority of that fact by December 1 of that year.

(5) In Ontario, subsection (4) does not apply to a person or company that complies with the filing and fee payment requirements applicable to an unregistered exempt international firm under Ontario Securities Commission Rule 13-502 *Fees*.

Investment dealers

41. A derivatives dealer that is registered as an investment dealer and that is a member of the Investment Industry Regulatory Organization of Canada is exempt from the requirements set out in Appendix B if the derivatives dealer complies with the corresponding conduct and other regulatory requirements of that organization in connection with the transaction or other activity.

Canadian financial institutions

42. A derivatives dealer that is a Canadian financial institution is exempt from the requirements set out in Appendix C if the derivatives dealer is subject to and complies with the corresponding conduct and other regulatory requirements of its prudential regulator in connection with the transaction or other activity.

INCLUDES COMMENT LETTERS

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

43. (1) For the purposes of subsection (3), "financial or other interest" includes the following:

(a) ownership, beneficial or otherwise, of the underlying interest or underlying interests of the derivative;

(b) ownership, beneficial or otherwise, of, or other interest in, a derivative that has the same underlying interest as the derivative;

(c) a commission or other compensation received or expected to be received from any person or company in relation to a transaction involving the derivative, an underlying interest in the derivative or a derivative that has the same underlying interest as the derivative;

(d) a financial arrangement in relation to the derivative, an underlying interest in the derivative or a derivative that has the same underlying interest as the derivative;

(e) any other interest that relates to the transaction.

(2) The requirements of this Instrument applicable to a derivatives adviser do not apply to a person or company that acts as a derivatives adviser if the advice that the person or company provides does not purport to be tailored to the needs of the person or company receiving the advice.

(3) If the person or company that is exempt under subsection (2) recommends a transaction involving a derivative, a class of derivatives or the underlying interest of a derivative or class of derivatives in which any of the following has a financial or other interest, the person or company must disclose the interest, including a description of the nature of the interest, concurrently with providing the advice:

(a) the person or company;

(b) any partner, director or officer of the person or company;

(c) where the person or company is an individual, the spouse or child of the individual;

(d) any other person or company that would be an insider of the first mentioned person or company if the first mentioned persons or company were a reporting issuer.

Foreign derivatives advisers

44. (1) A derivatives adviser whose head office or principal place of business is in a foreign jurisdiction is exempt from this Instrument in respect of advice provided to a derivatives party if

(a) the derivatives adviser does not provide advice to a person or company in the local jurisdiction that is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 43 [*Advising generally*];

INCLUDES COMMENT LETTERS

(b) the derivatives adviser is registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix D to conduct the derivatives activities in the foreign jurisdiction that it proposes to conduct with the derivatives party; and

(c) the derivatives adviser complies with the laws of the foreign jurisdiction applicable to the derivatives adviser set out in Appendix D relating to the activities being conducted.

(2) Despite subsection (1), a derivatives adviser relying on the exemption set out in that subsection must comply with the provisions of this Instrument set out in Appendix D opposite the name of the foreign jurisdiction in respect of the derivatives advice.

(3) The exemption under subsection (1) is not available to a person or company in respect of advice provided to a derivatives party unless all of the following apply:

(a) the head office or principal place of business of the person or company is in the foreign jurisdiction in which it is registered;

(b) the person or company engages in the business of a derivatives adviser in the foreign jurisdiction in which its head office or principal place of business is located;

(c) the person or company has delivered to the derivatives party a statement in writing disclosing the following:

(i) the foreign jurisdiction in which the person or company's head office or principal place of business is located;

(ii) that all or substantially all of the assets of the person or company may be situated outside of the local jurisdiction;

(iii) that there may be difficulty enforcing legal rights against the person or company because of the above;

(iv) the name and address of the agent for service of the person or company in the local jurisdiction;

(d) the person or company has submitted to the securities regulatory authority a completed Form 31-103F2 *Submission to Jurisdiction and Appointment of Agent for Service* under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

(e) the person or company is not in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in the jurisdiction;

(f) the person or company undertakes to the securities regulatory authority to provide the securities regulatory authority with prompt access to its books and records upon request.

INCLUDES COMMENT LETTERS

(4) A person or company that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or, in Québec, the securities regulatory authority of that fact by December 1 of that year.

(5) In Ontario, subsection (4) does not apply to a person or company that complies with the filing and fee payment requirements applicable to an unregistered exempt international firm under Ontario Securities Commission Rule 13-502 *Fees*.

PART 7
EXEMPTION

Exemption

45. (1) The regulator or the securities regulatory authority may grant an exemption from this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

(2) Despite subsection (1), in Ontario, only the regulator may grant such an exemption.

(3) Except in Alberta and Ontario, an exemption referred to in subsection (1) is granted under the statute referred to in Appendix B of National Instrument 14-101 *Definitions* opposite the name of the local jurisdiction.

PART 8
EFFECTIVE DATE

Effective date

46. (1) This Instrument comes into force on [*insert date*].

(2) In Saskatchewan, despite subsection (1), if these regulations are filed with the Registrar of Regulations after [*insert date*], these regulations come into force on the day on which they are filed with the Registrar of Regulations.

(3) Despite subsection (1) and, in Saskatchewan, subject to subsection (2), **[part ●]** comes into force [*insert date + 6 months]*.

(4) Despite subsections (1) to (3), Part ● does not apply to a transaction entered into before *[insert date]* if the derivative that is the subject of the transaction expires or terminates not later than 365 days after that day.

APPENDIX A
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

FOREIGN DERIVATIVES DEALERS
(Section 40)

LAWS, REGULATIONS OR INSTRUMENTS OF FOREIGN JURISDICTIONS APPLICABLE TO FOREIGN DERIVATIVES DEALERS

Foreign Jurisdiction	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a foreign derivatives dealer despite compliance with the foreign jurisdiction's laws, regulations or instruments

INCLUDES COMMENT LETTERS

APPENDIX B
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

INVESTMENT DEALERS
(Section 41)

LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO INVESTMENT DEALERS

IIROC	Laws, Regulations or Instruments	Provisions of this Instrument applicable to an investment dealer despite compliance with IIROC requirements

INCLUDES COMMENT LETTERS

APPENDIX C
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

CANADIAN FINANCIAL INSTITUTIONS
(Section 42)

LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO CANADIAN FINANCIAL INSTITUTIONS

Federal or provincial prudential regulator	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a Canadian Financial Institution despite compliance with applicable federal or provincial regulatory requirements

INCLUDES COMMENT LETTERS

APPENDIX D
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

FOREIGN DERIVATIVES ADVISERS
(Section 44)

LAWS, REGULATIONS OR INSTRUMENTS OF FOREIGN JURISDICTIONS APPLICABLE TO FOREIGN DERIVATIVES ADVISERS

Foreign Jurisdiction	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a foreign derivatives adviser despite compliance with the foreign jurisdiction's laws, regulations or instruments

INCLUDES COMMENT LETTERS

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ANNEX II

PROPOSED COMPANION POLICY 93-101
DERIVATIVES: BUSINESS CONDUCT

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PART 1
GENERAL COMMENTS

Introduction

This companion policy (the **Policy**) sets out the views of the Canadian Securities Administrators (the **CSA** or **we**) on various matters relating to National Instrument 93-101 *Derivatives: Business Conduct* (the **Instrument**) and related securities legislation.

Except for Part 1, the numbering and headings of Parts, sections and subsections in this Policy correspond to the numbering and headings in the Instrument. Any general guidance for a Part or section appears immediately after the Part or section name. Any specific guidance on a section or subsection follows any general guidance. If there is no guidance for a Part or section, the numbering in this Policy will skip to the next provision that does have guidance.

Unless otherwise stated, any reference to a Part, section, subsection, paragraph, subparagraph or definition in this Policy is a reference to the corresponding Part, section, subsection, paragraph, subparagraph or definition in the Instrument.

Definitions and interpretation

Unless defined in the Instrument or this Policy, terms used in the Instrument and in this Policy have the meaning given to them in securities legislation, including in National Instrument 14-101 *Definitions*. “Securities legislation” is defined in National Instrument 14-101 *Definitions*, and includes statutes and other instruments related to both securities and derivatives.

In this Policy, “Product Determination Rule” means,

- in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, Multilateral Instrument 91-101 *Derivatives: Product Determination*,

- in Manitoba, Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*,

- in Ontario, Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*, and

- in Québec, *Regulation 91-506 respecting Derivatives Determination*.

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Interpretation of terms defined in the Instrument

Section 1 – Definition of Canadian financial institution

The definition of "Canadian financial institution" in the Instrument is consistent with the definition of this term in National Instrument 45-106 *Prospectus Exemptions* with one exception. The definition of this term in National Instrument 45-106 *Prospectus Exemptions* does not include a Schedule III bank (due to the separate definition of the term "bank" in National Instrument 45-106 *Prospectus Exemptions*), with the result that National Instrument 45-106 *Prospectus Exemptions* contains certain references to "a Canadian financial institution or a Schedule III bank". The definition of this term in the Instrument includes a Schedule III bank.

Section 1 – Definition of derivatives adviser and derivatives dealer

A person or company that meets the definition of "derivatives adviser" or "derivatives dealer" in a local jurisdiction is subject to the Instrument in that jurisdiction, whether or not they are registered or exempted from the requirement to be registered in that jurisdiction.

A person or company will be subject to the requirements of the Instrument if they are

- in the business of trading derivatives or in the business of advising others in respect of derivatives, or

- otherwise required to register as a derivatives dealer or a derivatives adviser as a consequence of engaging in certain specified activities set out in Proposed National Instrument 93-102 *Derivatives: Registration*.

Factors in determining business purpose

In determining whether a person or company is in the business of trading or in the business of advising in derivatives, a number of factors should be considered. The factors are set out below.

This is not a complete list of factors and other factors may also be considered.

- *Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

- *Directly or indirectly carrying on the activity with repetition, regularity or continuity* – Frequent or regular transactions are a common indicator that a person or company may be engaged in trading or advising for a business purpose. The activity does not have to be their sole or even primary endeavour for them to be in the business. We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose.

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- *Facilitating or intermediating transactions* – The person or company provides services relating to the facilitation of trading or intermediation of transactions in derivatives between third-party counterparties to derivatives contracts. This typically takes the form of the business commonly referred to as a broker.

- *Transacting with the intention of being compensated* – The person or company receives, or expects to receive, any form of compensation for carrying on derivatives transaction activity. This would include any compensation that is transaction- or value-based including from spreads or built-in fees. It does not matter if the person or company actually receives compensation or what form the compensation takes. However, a person or company would not be considered to be a derivatives dealer solely by reason that it realizes a profit from changes in the market price for the derivative (or its underlying reference asset), regardless of whether the derivative is intended for the purpose of hedging or speculating.

- *Directly or indirectly soliciting in relation to derivatives transactions* – The person or company contacts others to solicit derivatives transactions. Solicitation includes contacting someone by any means, including communication that offers (i) transactions, (ii) participation in transactions or (iii) services relating to transactions. This includes advertising on the internet with the intention of encouraging transacting in derivatives by local persons or companies. A person or company might not be considered to be soliciting solely because it contacts a potential counterparty, or a potential counterparty contacts them to enquire about a transaction in a derivative, unless it is the person or company's intention or expectation to be compensated from the transaction. For example, a person or company that wishes to hedge a specific risk might not be considered to be soliciting for the purpose of the Instrument if they contacted multiple potential counterparties to enquire about potential derivatives transactions to hedge the risk.

- *Engaging in activities similar to a derivatives adviser or derivatives dealer* – The person or company carries out any activities related to transactions involving derivatives that would reasonably appear, to a third party, to be similar to the activities discussed above. This would not include the operator of an exchange or a clearing agency.

- *Providing derivatives clearing services* – The person or company provides services to allow third parties, including counterparties to transactions involving the person or company, to clear derivatives through a clearing agency. These services are actions in furtherance of a trade conducted by a person or company that would typically play the role of an intermediary in the derivatives market

In determining whether or not they are, for the purposes of the Instrument, a derivatives dealer or derivatives adviser, a person or company should consider their activities holistically. We do not consider that all of the factors discussed above necessarily carry the same weight or that any one factor will be determinative.

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Generally, we would consider a person or company that engages in the activities discussed above in an organized and repetitive manner to be a derivatives dealer or, depending on the context, a derivatives adviser. Ad hoc or isolated instances of the activities discussed above may not necessarily result in a person or company being a derivatives dealer or, depending on the context, a derivatives adviser. For example, if a person or company makes an effort to take a long and short position at the same time to manage business risk, this does not necessarily mean that the person or company is making a market. Similarly, organized and repetitive proprietary trading, in and of itself, absent other factors described above, may not result in a person or company being considered to be a derivatives dealer for the purpose of the Instrument.

A derivatives dealer or a derivatives adviser in a local jurisdiction is a person or company that conducts the activities described in this section in that jurisdiction. For example, this would include a person or company that is located in a local jurisdiction and that conducts dealing or advising activity in that local jurisdiction or in a foreign jurisdiction. This would also include a person or company located in a foreign jurisdiction that conducts dealing or advising activity with a counterparty located in the local jurisdiction. A person or company does not need to have a physical location, staff or other presence in the local jurisdiction to be a derivatives dealer or derivatives adviser in that jurisdiction.

A person or company's primary business activity does not need to include the activities described above for the person or company to be a derivatives dealer or derivatives adviser for the purpose of the Instrument. The factors described above could represent only a small portion of the person or company's overall business activities. However, if these factors are present, it may be a derivatives dealer or derivatives adviser in the jurisdiction in which it engages in those activities.

Section 4 provides that a person or company is not a derivatives dealer or derivatives adviser for the purpose of the Instrument if they would be a dealer or adviser solely as a result of carrying out the activities described above in relation to one or more affiliated entities of the person or company.

Section 1 – Definition of derivatives party assets

"Derivatives party assets" includes all assets of a derivatives party that are received or held by a derivatives firm for or on behalf of the derivatives party for any purpose relating to derivatives transactions. This will include collateral delivered as initial or variation margin.

Section 1 – Definition of eligible derivatives party

Certain requirements of the Instrument do not apply where a derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party that is not an individual. If the derivatives firm is dealing with or advising a derivatives party who is an eligible derivatives party and is an individual, these requirements apply but may be waived in writing. Section 7 of this Policy provides additional guidance relating to this waiver.

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A derivatives firm should take reasonable steps to determine whether a derivatives party is an eligible derivatives party before transacting with or advising them. In determining whether the person or company that it transacts with or advises is an eligible derivatives party, the derivatives firm may rely on factual representations made in writing by the derivatives party, unless a reasonable person would have grounds to believe that such statements are false or it is otherwise unreasonable to rely on the representation. The criteria for determining whether a derivatives party is an eligible derivatives party are to be applied at the time a particular derivative is first entered into. A derivatives firm is not required to ensure that the derivatives party continues to be an eligible derivatives party during the life of the particular derivative but must consider the derivative party's eligible derivatives party status before entering into a new transaction with that derivatives party.

Section 1 – Definition of eligible derivatives party – subsections (m) and (n)

Under paragraphs (m) and (n) of the definition of "eligible derivatives party", a person or company will only be considered an eligible derivatives party if they have represented in writing to the derivatives firm that they have the requisite knowledge and experience, and they have the minimum assets specified in the applicable paragraph.

If the derivatives firm has not received a written factual statement from a derivatives party, the derivatives firm should consider the derivatives party not to be an eligible derivatives party.

We expect that a derivatives firm would maintain a copy of each derivatives party's written representation about its status as an eligible derivatives party and would have policies and procedures reasonably designed to ensure that the information relating to each derivatives party is up to date.

Whether it is reasonable for a derivatives firm to rely on a derivative's party's written representation will depend on the particular facts and circumstances of the derivatives party and its relationship with the derivatives firm.

For example, in determining whether it is reasonable to rely on a derivative's party's representation that it has the requisite knowledge and experience, a derivatives firm may consider factors such as

- whether the derivatives party enters into transactions with frequency and regularity,
- whether the derivatives party has staff who have experience in derivatives and risk management,
- whether the derivatives party has retained independent advice in relation to its derivatives, and
- publically available financial information.

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Taking the above factors into consideration, some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type.

Section 1 – Definition of permitted depository

In recognition of the international nature of the derivatives market, paragraph (e) of the definition of "permitted depository" permits a foreign bank or trust company with a minimum amount of reported shareholders' equity to act as a permitted depository and hold derivatives party assets, provided its head office or principal place of business is located in a permitted jurisdiction and it is regulated as a bank or trust company in the permitted jurisdiction.

Section 1 – Definition of permitted investment

The term "permitted investment" sets out a principles-based approach to determining the types of instruments in which a derivatives firm may invest derivatives party assets, in accordance with the provisions of the Instrument. The term is intended to cover an investment in an instrument that is secured by, or is a claim on, high-quality debtors, and which allows for quick liquidation with little, if any, adverse price effect, for the purpose of mitigating market, credit and liquidity risk.

We expect that a derivatives firm that invests derivatives party assets in accordance with the Instrument would ensure such investment is:

- consistent with its overall risk-management strategy, and
- fully disclosed to its customers.

We are also of the view that it would be inconsistent with the principles-based approach to permitted investments for a derivatives firm to invest derivatives party assets in its own securities or those of its affiliated entities.

Examples of instruments that would be considered permitted investments by the local securities regulatory authority include the following:

- debt securities issued by or guaranteed by the Government of Canada or the government of a province or territory of Canada;
- debt securities that are issued or guaranteed by a municipal corporation in Canada;
- certificates of deposit, that are not securities, issued by a bank listed in Schedule I, II or III to the *Bank Act* (Canada) (the "Bank Act");[1]

[1] *Bank Act* (SC 1991, c 46).

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- commercial paper fully guaranteed as to principal and interest by the Government of Canada;

- interests in money market mutual funds.

We are also of the view that foreign investments in high-quality obligors exhibiting the same conservative characteristics as the instruments listed above would be acceptable.

Section 1 – Definition of permitted jurisdiction

Paragraph (a) of the definition of "permitted jurisdiction" captures jurisdictions where foreign banks authorized under the Bank Act to carry on business in Canada, subject to supervision by the Office of the Superintendent of Financial Institutions (**OSFI**), are located.[2] As of the time of the publication of this Instrument the following countries and their political subdivisions are included: Belgium, France, Germany, Ireland, Japan, Netherlands, Singapore, Switzerland, United Kingdom, and the United States of America.

For paragraph (b) of the definition of "permitted jurisdiction," in the case of the euro, where the currency does not have a single "country of origin", the provision will be read to include all countries in the euro area[3] and countries using the euro under a monetary agreement with the European Union.[4]

Section 1 – Definition of segregate

While the term "segregate" means to separately hold or separately account for derivatives party assets or positions, consistent with the PFMI Report and National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*, accounting segregation is acceptable.

For the purpose of this section "PFMI Report" means the April 2012 final report entitled *Principles for financial market infrastructures* published by the Bank for International Settlements' Committee on Payments and Market Infrastructure (formerly the Committee on Payment and Settlement Systems) and the Technical Committee of the International Organization of Securities Commissions, as amended from time to time.

[2] *Ibid.* at Part XII.1; For a list of authorized foreign banks regulated under the *Bank Act* and subject to OSFI supervision, see: Office of the Superintended of Financial Institutions, *Who We Regulate* (available: http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11).

[3] European Union, Economic and Financial Affairs, *What is the euro area?*, May 18, 2015, online: European Union (http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm).

[4] European Union, Economic and Financial Affairs, *The euro outside the euro area*, April 9, 2014, online: European Union (https://ec.europa.eu/info/business-economy-euro/euro-area/euro/use-euro/euro-outside-euro-area_en).

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Section 1 – Definition of valuation

We are of the view that the valuation can be calculated based upon the use of an industry-accepted methodology that is in accordance with accounting principles and that results in a reasonable valuation of the derivative[5] such as mark-to-market or mark-to-model. We expect that the methodology used to calculate the valuation that is reported with respect to a derivative would be consistent over the entire life of the derivative.

PART 2
APPLICATION

Section 2 – Application to registered and unregistered derivatives firms

The Instrument applies to "derivatives advisers" and "derivatives dealers" as defined in subsection 1(1) of the Instrument. These definitions include a person or company registered as a "derivatives dealer" or "derivatives adviser" under securities legislation. The Instrument applies even if the person or company is exempted or excluded from registration. Accordingly, derivatives firms that may be exempted from registration in a jurisdiction, such as Canadian financial institutions, will nevertheless be subject to a similar standard of conduct towards their derivatives parties as the standard of conduct applicable to registered derivatives firms and their representatives.

Section 3 – Scope of instrument

This section ensures that the Instrument applies to the same contracts and instruments in all jurisdictions of Canada. Each jurisdiction has adopted a Product Determination Rule that excludes certain types of contracts and instruments from being derivatives for the purpose of the Instrument.

Section 7 – Requirements that apply when dealing with or advising an eligible derivatives party

The term "eligible derivatives party" is intended to refer to those derivatives parties that do not require the full set of protections afforded to derivatives parties that do not have the financial resources or expertise to meet the eligible derivatives party thresholds.

The obligations of a derivatives firm and individuals acting on its behalf towards a derivatives party differ depending on the nature of the derivatives party.

Section 7 – Requirements that apply when dealing with or advising a derivatives party that is not an eligible derivatives party

All of the requirements in Parts 3, 4 and 5 of the Instrument apply to a derivatives firm when dealing with or advising a derivatives party that is not an eligible derivatives party.

[5] For example, see International Financial Reporting Standard 13 *Fair Value Measurement*.

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Subsection 7(1) – Requirements that apply when dealing with or advising an eligible derivatives party that is not an individual

Only certain requirements in the Instrument apply to a derivatives firm when the derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party and that is not an individual:

In Part 3 Dealing With or Advising Derivatives Parties,

- all of Division 1 – General Obligations Towards All Derivatives Parties, comprising section 8 [*Fair dealing*], section 9 [*Conflicts of interest*] and section 10 [*Know your derivatives party*], applies, and

- all other requirements in Part 3 do not apply.

In Part 4 Derivatives Party Accounts,

- in Division 2 – Derivatives Party Assets, section 24 [*Interaction with NI 94-102*] and section 25 [*Segregating derivatives party assets*] apply, and

- all other requirements in Part 4 do not apply.

In Part 5 Compliance,

- all of Division 1 – Compliance applies, and

- all of Division 2 – Recordkeeping applies.

Subsection 7(2) – Requirements that apply when dealing with or advising an eligible derivatives party that is an individual but that may be waived by the individual

If the derivatives firm is dealing with or advising a derivatives party that is an eligible derivatives party and an individual, the requirements of the Instrument apply to the derivatives firm in respect of such dealing or advice. However, the individual eligible derivatives party may agree to waive in writing any or all of the requirements of the Instrument, other than the requirements set out in subsection 7(1).

In the case of a waiver by an individual eligible derivatives party, the waiver may be included in account-opening documentation or other relationship disclosure and will be valid for up to 365 days. If the derivatives firm wishes to continue to be able to rely on a waiver from the individual eligible derivatives party more than 365 days after it has been given, the derivatives firm will need to obtain a new waiver in writing from the derivatives party.

There is no prescribed form for the waiver contemplated by subsection 7(2) of the Instrument. However, consistent with the derivatives firm's obligation to deal fairly, honestly and in good faith with derivatives parties, we expect the waiver to be presented to the derivatives party in a

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clear and meaningful manner in order to ensure the derivatives party understands the information presented and the significance of the protections being waived.

PART 3
DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Section 8 – Fair dealing

The fair dealing obligation in section 8 is a principles-based obligation and is intended to be similar to the fair dealing obligation applicable to registered firms and registered individuals under Canadian securities legislation (the **registrant fair dealing obligation**).[6]

The fair dealing obligation should be interpreted flexibly and in a manner sensitive to context

We recognize that there are important differences between derivatives markets and securities markets, with the result that the fair dealing obligation under the Instrument may not always apply to derivatives market participants in the same manner as the registrant fair dealing obligation would apply to securities market participants. Accordingly, we believe that the fair dealing obligation in section 8, as a principles-based obligation, should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations. For this reason, prior CSA guidance and case law on the registrant fair dealing obligation may not necessarily be relevant in interpreting the fair dealing obligation under the Instrument. Similarly, the guidance in this Policy is not necessarily applicable to registrants in their conduct with securities market participants.

We take the view that the concept of fairness when applied to derivatives market participants is context-specific. Conduct that may be considered unfair when dealing with a derivatives party that is not an eligible derivatives party may be considered fair and part of ordinary commercial practice when dealing with an eligible derivatives party. For example, the fair dealing obligation may be different if the derivative party is an individual or small business from what it would be if the derivative party were a sophisticated market participant such as a global financial institution. Similarly, conduct that may be considered to be unfair when acting as an agent to facilitate a derivatives transaction with a third-party may be considered fair when entering into a

[6] See section 14 of the Securities Rules, B.C. Reg. 194/97 **[B.C. Regulations]** under the *Securities Act* (British Columbia), R.S.B.C. 1996, c. 418 **[B.C. Act]**; section 75.2 of the *Securities Act* (Alberta) R.S.A. 2000, c.S-4 **[Alberta Act]**; section 33.1 of *The Securities Act, 1988* (Saskatchewan), S.S. 1988-89, c. S-42.2 **[Saskatchewan Act]**; subsection 154.2(3) of *The Securities Act* (Manitoba) C.C.S.M. c. S50 **[Manitoba Act]**; section 2.1 of OSC Rule 31-505 *Conditions of Registration* ; section 65 of the *Derivatives Act* (Québec), R.S.Q., c. 14.01 **[Québec Act]**; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 **[N.S. Act]**; subsection 54(1) of the *Securities Act* (New Brunswick) S.N.B. 2004, c. S-5.5 **[N.B. Act]**; section 90 of the *Securities Act* (Prince Edward Island), R.S.P.E.I. 1988, c. S-3.1 **[P.E.I. Act]**; subsection 26.2(1) of the *Securities Act* (Newfoundland and Labrador), R.S.N.L.1990, c. S-13 **[Newfoundland Act]**; section 90 of the *Securities Act* (Nunavut), S.Nu. 2008, c. 12 **[Nunavut Act]**; section 90 of the *Securities Act* (Northwest Territories), S.N.W.T. 2008, c. 10 **[N.W.T. Act]**; and section 90 of the *Securities Act* (Yukon), S.Y. 2007, c. 16 **[Yukon Act]**.

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derivative as principal when it would be expected that each party negotiating the derivative is seeking to ensure favourable financial terms.

Section 9 – Conflicts of interest

We recognize that there are important differences between derivatives markets and securities markets, with the result that the conflict of interest provisions under the Instrument may not always apply to derivatives market participants in the same manner as they would for securities market participants. Accordingly, we believe that the conflict of interest provisions in section 9 should be interpreted flexibly and in a manner that is sensitive to context and to derivatives market participants' reasonable expectations. For this reason, prior CSA guidance and case law on conflicts of interest may not necessarily be relevant in interpreting the conflict of interest provisions under the Instrument. Similarly, the guidance in this Policy is not necessarily applicable to registrants in their conduct with securities market participants.

We take the view that the concept of conflict of interest when applied to derivatives market participants is context-specific. Circumstances that may be considered to give rise to a conflict of interest when dealing with a derivatives party that is not an eligible derivatives party may be considered fair and part of ordinary commercial practice when dealing with an eligible derivatives party. For example, conflicts of interests may be treated differently when dealing with a derivative party that is an individual or small business from how they would be treated if the derivative party were a sophisticated market participant such as a global financial institution.

In addition, the circumstances that may be considered to give rise to a conflict of interest when acting as an intermediary on behalf of an eligible derivatives party may not represent a conflict of interest when entering into a derivative as principal where the derivatives party is reasonably aware that derivatives firm is negotiating the derivative as a commercial arrangement.

Subsection 9(1) – Identifying conflicts of interest

Section 9 of the Instrument requires a derivatives firm to take reasonable steps to identify existing material conflicts of interest and material conflicts that the derivatives firm reasonably expects to arise between the derivatives firm and their derivatives parties.

We consider a conflict of interest to be any circumstance where the interests of a derivatives party and those of a derivatives firm or its representatives, are inconsistent or divergent.

Subsection 9(2) – Responding to conflicts of interest

We expect that a derivatives firm's policies and procedures for managing conflicts would allow the firm and its staff to

- identify conflicts of interest,
- determine the level of risk that a conflict of interest raises, and

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- respond appropriately to conflicts of interest.

When responding to any conflict of interest, we expect a derivatives firm to consider the fair dealing obligation in Part 3 of the Instrument as well as any other standard of care that may apply when dealing with or advising a derivatives party.

In general, we view three methods as reasonable to respond to a conflict of interest, depending on the circumstances: avoidance, control and disclosure.

If a derivatives firm allows a serious conflict of interest to continue, there is a high risk of harm to derivatives parties or to the market. We expect that if there is a material risk of harm to a derivatives party or the integrity of the markets, the derivatives firm will take all reasonable steps to avoid the conflict of interest. If the derivatives firm does not avoid the conflict of interest, we expect that it will take steps to either control or disclose the conflict, or both. We would also expect the derivatives firm to consider what internal structures or policies and procedures it should implement to reasonably respond to such a conflict of interest.

Avoiding conflicts of interest

A derivatives firm must avoid all conflicts of interest that are prohibited by law. If a conflict of interest is not prohibited by law, we expect the derivatives firm to avoid the conflict if it is sufficiently contrary to the interests of a derivatives party that there can be no other reasonable response. Conflicts that have a lesser impact on the interests of a derivatives party can be managed through controls or disclosure.

Where conflicts of interest are so contrary to another person's or company's interest that a derivatives party cannot use controls or disclosure to reasonably respond to them, we expect that the derivatives firm to avoid the conflict, stop providing the service or stop dealing with the derivatives party.

Controlling conflicts of interest

We would expect that a derivatives firm would design its organizational structures, lines of reporting and physical locations to control conflicts of interest effectively. For example, the following situations would likely raise a potential conflict of interest:

- advisory staff reporting to marketing staff,

- compliance or internal audit staff reporting to a business unit, and

- individuals acting on behalf of a derivatives firm and investment banking staff in the same physical location.

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Depending on the conflict of interest, a derivative firm may control the conflict in an appropriate way, including by

- assigning a different individual to provide a service to the particular derivatives party,
- creating a group or committee to review, develop or approve responses,
- monitoring trading activity, or
- using information barriers for certain internal communication.

Subsection 9(3) – Disclosing conflicts of interest

When disclosure is appropriate

We expect a derivatives firm to inform its derivatives parties about any conflicts of interest that could affect the services the firm provides to them.

Timing of disclosure

Under subsection 9(3), a derivatives firm and individuals acting on its behalf must disclose the conflict in a timely manner. We expect a derivatives firm and its representatives to disclose a conflict of interest to a derivatives party before or at the time they recommend the transaction or provide the service that gives rise to the conflict.

Where this disclosure is provided to a derivatives party before the transaction takes place, we expect the disclosure to be provided shortly before the transaction takes place. For example, if it was initially provided with the derivative party's account-opening documentation months or years previously, we would expect that an individual acting on behalf of a derivatives firm to also disclose this conflict to the derivatives party shortly before the transaction or at the time the transaction is recommended.

When disclosure is not appropriate

Disclosure may not be appropriate if a conflict of interest involves confidential or commercially-sensitive information, or the information amounts to "inside information" under insider trading provisions in securities legislation. In these situations, a derivatives firm will need to assess whether there are other methods to adequately respond to the conflict of interest. If not, the firm may have to decline to provide the service to avoid the conflict of interest. We would also expect a derivatives firm to have specific procedures for responding to conflicts of interest that involve inside information and for complying with insider trading provisions.

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How to disclose a conflict of interest

Subsection 9(3) provides that a derivatives firm must provide disclosure about a material conflict of interest to a derivatives party. When a derivatives firm provides this disclosure, we expect that the disclosure would

- be prominent, specific, clear and meaningful to the derivatives party, and
- explain the conflict of interest and how it could affect the service the derivatives party is being offered.

We would expect that a derivatives firm would not

- provide only generic disclosure,
- provide only partial disclosure that could mislead the derivatives party, or
- obscure conflicts of interest in overly detailed disclosure.

Examples of conflicts of interest

Specific situations where a derivatives firm could be in a conflict of interest and how to manage the conflict are described below.

Acting as both dealer and counterparty

When a derivatives firm enters into a transaction with or recommends a transaction to a derivatives party, and the derivatives firm or an affiliated entity of the derivatives firm is the counterparty to the derivatives party in the transaction, we expect that the derivatives firm would respond to the resulting conflict of interest by disclosing it to the derivatives party.

Competing interests of derivatives parties

If a derivatives firm deals with or provides advice to multiple derivatives parties, we would expect the derivatives firm to make reasonable efforts to be fair to all such derivatives parties. We expect that a derivatives firm will have internal systems to evaluate the balance of these interests.

Compensation practices

We expect that a derivatives firm would consider whether any particular benefits, compensation or remuneration practices are inconsistent with their obligations to derivatives parties, especially if the firm relies heavily on commission-based remuneration. For example, if there is a complex product that carries a high commission but may not be appropriate for the derivatives firm's derivatives parties, the derivatives firm may decide that it is not appropriate to offer that product.

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If such compensation practices are adopted, a derivatives firm might consider employing persons that do not receive compensation based on derivatives activity to conduct the supervision of staff receiving compensation based on derivatives activity.

DIVISION 2 – ADDITIONAL OBLIGATIONS WHEN DEALING WITH OR ADVISING CERTAIN DERIVATIVES PARTIES

The obligations in Division 2 of Part 3 do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 11 – Derivatives-party-specific needs and objectives

Information on a derivatives party's specific needs and objectives (sometimes referred to as "derivatives-party-specific KYC information") forms the basis for determining whether transactions in derivatives are suitable for a derivatives party. The obligations in section 11 require a derivatives firm to take reasonable steps to obtain and periodically update information about their derivatives parties.

The derivatives-party-specific KYC information may also be relevant in complying with policies and procedures that are aimed at ensuring the most advantageous terms of a derivative for a derivatives party under subsection 19(1). Derivatives parties may have a variety of execution priorities. For example, a derivatives party may have as their primary objective the objective of having the transaction executed as quickly as possible rather than trying to obtain the best available price. Factors to consider when evaluating execution include price, certainty, timeliness, and minimizing impact cost of making a trading interest public.

Before transacting with a derivatives party, we expect a derivatives firm to have the appropriate information needed to assess the derivatives party's knowledge, experience and level of understanding of the relevant type of derivative, the derivative's party's objective in entering into the derivative and the risks involved in order to assess whether the derivative is suitable for the derivatives party. The derivatives-party-specific KYC information is obtained with this goal in mind.

If the derivatives party chooses not to provide the necessary information that would enable the derivatives firm to assess suitability, or if the derivatives party provides insufficient information, the firm should advise the derivatives party that it is required to request this information from them in order to determine whether the derivative is suitable for them or their priorities when transacting in the derivative. The derivatives firm should also indicate that without such information there is a strong risk that it will not be able to determine whether the derivatives party has the ability to understand the derivative and the risks involved with transacting the particular derivative.

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Derivatives-party-specific KYC information for suitability depends on circumstances

The extent of derivatives-party-specific KYC information a derivatives firm needs to determine the suitability of a transaction or a derivatives party's priorities when transacting in the derivative will depend on factors that include

- the derivatives party's circumstances and objectives,
- the type of derivative,
- the derivatives party's relationship to the derivatives firm, and
- the derivatives firm's business model.

In some cases, a derivatives firm will need extensive KYC information, for example, where the derivatives party would like to enter into a derivatives strategy to hedge a commercial activity in a range of asset classes. In these cases, we would expect the derivatives firm to have a comprehensive understanding of the derivatives party's

- hedging needs and objectives, including the derivatives party's time horizon for their hedging strategy,
- overall financial circumstances, and
- risk tolerance for various types of derivatives, taking into account the derivative party's investment knowledge.

In other cases, a derivatives firm may need to obtain less KYC information, for example, if the derivatives firm enters into a single derivative with a derivatives party who needs to hedge a loan that the derivatives firm extended to the derivatives party.

Section 12 – Suitability

Subsection 12(1) requires a derivatives firm to take reasonable steps to ensure that a proposed transaction is suitable for a derivatives party before making a recommendation or accepting instructions from the derivatives party to transact in a derivative.

Suitability obligation

To meet the suitability obligation, the derivatives firm should have in-depth knowledge of all derivatives that it transacts in with or for, or is recommending to, its derivatives party. This is often referred to as the "know your product" or KYP obligation.

We expect a derivatives firm to know each derivative well enough to understand and explain to the derivatives party the derivative's risks, key features, and initial and ongoing obligations. The decision by a derivatives firm to include a type of derivative on its product shelf or approved list

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of products does not necessarily mean that the derivative will be suitable for each derivatives party. Individuals acting on behalf of a derivatives firm must still determine the suitability of each transaction for every derivatives party.

When assessing suitability, we expect a derivatives firm to take all reasonable steps to determine whether the derivatives party has the capability to understand the particular type of derivative and the risks involved.

In all cases, we expect derivatives firms to be able to demonstrate a process for making suitability determinations that are appropriate under the circumstances.

Suitability obligations cannot be delegated

A derivatives firm is not permitted to

- delegate its suitability obligations to anyone else, or

- satisfy the suitability obligation by simply disclosing the risks involved with a transaction.

Section 11 and 12 - Use of online services to determine derivatives party needs and objectives and suitability

The conduct obligations set out in the Instrument, including the KYC and suitability obligations in sections 11 and 12 of the Instrument, are "technology neutral". This means that these obligations are the same for derivatives firms that interact with derivatives parties on a face-to-face basis or through an online platform.

Where the information necessary to fulfill derivatives firms' obligations pursuant to sections 11 and 12 of the Instrument is solicited through an online service or questionnaire, the CSA expects that this process would amount to a meaningful discussion with the derivatives party.

An online service or questionnaire will achieve this objective if it

- uses a series of behavioural questions to establish risk tolerance and elicit other KYC information,

- prevents a derivatives party from progressing further until all questions have been answered,

- tests for inconsistencies or conflicts in the answers and will not let the derivatives party complete the questionnaire until the conflict is resolved,

- offers information about the terms and concepts involved, and

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- reminds the derivatives party that an individual from the derivatives firm is available to help them throughout the process.

Section 13 – Permitted referral arrangements

Subsection 1(1) defines a "referral arrangement" in broad terms. Referral arrangement means an arrangement in which a derivatives firm agrees to pay or receive a referral fee. The definition is not limited to referrals for providing derivatives, financial services or services requiring registration. It also includes receiving a referral fee for providing a derivatives party name and contact information to an individual or firm. "Referral fee" is also broadly defined. It includes sharing or splitting any commission resulting from a transaction.

Under section 13, parties to a referral arrangement are required to set out the terms of the arrangement in a written agreement. This is intended to ensure that each party's roles and responsibilities are made clear. This includes obligations for a derivatives firm involved in referral arrangements to keep records of referral fees. Payments do not necessarily have to go through a derivatives firm, but a record of all payments related to a referral arrangement must be kept.

We expect referral agreements to include

- the roles and responsibilities of each party,
- limitations on any party that is not a derivatives firm,
- the disclosure to be provided to referred derivatives parties, and
- who provides the disclosure to referred derivatives parties.

If the individual or the derivatives firm receiving the referral is a derivatives firm or an individual acting on its behalf, they are responsible for carrying out all obligations of a derivatives firm towards a derivatives party and communicating with referred derivatives parties.

A derivatives firm is required to be a party to referral agreements. This ensures that it is aware of these arrangements so it can adequately supervise the individuals acting on its behalf and monitor compliance with the agreements. This does not preclude the individual acting on behalf of the derivatives firm from also being a party to the agreement.

A party to a referral arrangement may need to be registered depending on the activities that the party carries out. A derivatives firm cannot use a referral arrangement to assign, contract out of or otherwise avoid its regulatory obligations.

In making referrals, a derivatives firm should ensure that the referral does not itself constitute an activity that the derivatives firm is not authorized to engage in.

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Section 14 – Verifying the qualifications of the person or company receiving the referral

Section 14 requires the derivatives firm making a referral to satisfy itself that the party receiving the referral is appropriately qualified to perform the services, and, if applicable, is appropriately registered. The derivatives firm is responsible for determining the steps that are appropriate in the particular circumstances. For example, this may include an assessment of the types of derivatives parties that the referred services would be appropriate for.

Section 15 – Disclosing referral arrangements to a derivatives party

The disclosure of information to a derivatives party required under section 15 is intended to help a derivatives party make an informed decision about the referral arrangement and to assess any conflicts of interest. We expect the disclosure to be provided to a derivatives party before or at the time the referred services are provided. We would also expect a derivatives firm, and any individuals acting on behalf of the derivatives firm who are directly participating in the referral arrangement, to take reasonable steps to ensure that a derivatives party understands

- which entity they are dealing with,
- what they can expect that entity to provide to them,
- the derivatives firm's key responsibilities to them,
- if applicable, the limitations of the derivatives firm's registration category,
- if applicable, any relevant terms and conditions imposed on the derivatives firm's registration,
- the extent of the referrer's financial interest in the referral arrangement, and
- the nature of any potential or actual conflict of interest that may arise from the referral arrangement.

Section 17 – Handling complaints

General duty to document and respond to complaints

Section 17 requires a derivatives firm to document complaints and to effectively and fairly respond to them. We expect that a derivatives firm would document and respond to all complaints received from a derivatives party who has dealt with the derivatives firm (in this section, a "complainant").

Complaint handling policies

We are of the view that an effective complaint system would deal with all formal and informal complaints or disputes in a timely and fair manner. To achieve the objective of handling

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complaints fairly, we would expect the derivatives firm's compliance system to include standards allowing for objective factual investigation and analysis of the matters specific to the complaint.

We expect a derivatives firm to take a balanced approach to the gathering of facts that objectively considers the interests of

- the complainant,
- the individual or individuals acting on behalf of the derivatives firm, and
- the derivatives firm.

We would also expect a derivatives firm to not limit its consideration and handling of complaints to those relating to possible violations of securities legislation.

Complaint monitoring

We would expect a derivatives firm's complaint handling policy to provide for specific procedures for reporting the complaints to superiors, in order to allow the detection of frequent and repetitive complaints made with respect to the same matter which may, on a cumulative basis, indicate a serious problem. We would also expect the derivatives firm to take appropriate measures to promptly address the cause of a problem, particularly a serious problem.

Responding to complaints

Types of complaints

We expect that all complaints relating to one of the following matters would be responded to by the derivatives firm by providing an initial and substantive response, both in writing and within a reasonable time:

- a trading or advising activity,
- a breach of the derivatives party's confidentiality,
- theft, fraud, misappropriation or forgery,
- misrepresentation,
- an undisclosed or prohibited conflict of interest, or
- personal financial dealings with a derivatives party.

A derivatives firm may determine that a complaint relating to matters other than the matters listed above is nevertheless of a sufficiently serious nature to be responded to in the manner

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described below. This determination should be made, in all cases, by considering if a derivatives party, acting reasonably, would expect a written response to their complaint.

When complaints are not made in writing

We would not expect that complaints relating to matters other than those listed above, when made orally and when not otherwise considered serious based on a derivatives party's reasonable expectation, would need to be responded to in writing. However, we do expect that oral complaints be given as much attention as written complaints. If a complaint is made orally and is not clearly expressed, the derivatives firm may request the complainant to put the complaint in writing and we would expect a derivatives firm to offer reasonable assistance to do so.

A derivatives firm is entitled to expect the complainant to put unclear oral issues into written format in order to try to resolve confusion about the nature of the issue. If the oral complaint is clearly frivolous, we do not expect a derivatives firm to offer assistance to put the complaint in writing. The derivatives firm may nonetheless ask the complainant to put the complaint in writing on his or her own.

Timeline for responding to complaints

We expect that a derivatives firm would

- promptly send an initial written response to a complainant – we consider that an initial response should be provided to the complainant within 5 business days of receipt of the complaint, and
- provide a substantive response to all complaints relating to the matters listed under "Types of complaints" above, indicating the derivatives firm's decision on the complaint.

A derivatives firm may also wish to use its initial response to seek clarification or additional information from the derivatives party.

We encourage derivatives firms to resolve complaints relating to the matters listed above within 90 days.

DIVISION 3 – RESTRICTIONS ON CERTAIN BUSINESS PRACTICES WHEN DEALING WITH NON-ELIGIBLE DERIVATIVES PARTIES

The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 18 – Tied selling

Section 18 prohibits a derivatives firm from imposing undue pressure on or coercing a person or company to obtain a product or service from a particular person or company, including the

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derivatives firm or any of its affiliates, as a condition of obtaining another product or service from the derivatives firm. These types of practices are known as "tied selling". In our view, this section would be contravened if, for example, a financial institution agreed to lend money to a derivatives party on the condition that the derivatives party hedged their loan through the same financial institution. In this example, we would take the view that a derivatives firm would not contravene section 18 if it required the derivatives party to enter into an interest rate derivative in connection with a loan agreement as long as the derivatives party were permitted to transact in this derivative with the counterparty of their choice.

However, section 18 is not intended to prohibit relationship pricing or other beneficial selling arrangements similar to relationship pricing. Relationship pricing refers to the practice of industry participants offering financial incentives or advantages to certain derivatives parties.

Subsection 19(1) – Fair terms and pricing when acting as agent

What constitutes "most advantageous terms" will vary depending on the particular circumstances and a derivatives firm may not be able to achieve the most advantageous terms for every single transaction that it executes on behalf of a derivatives party. The derivatives firm should be able to demonstrate that it has set and follows policies and procedures that are reasonably designed to achieve the most advantageous terms for the derivatives firm's derivatives parties and that these policies and procedures are reviewed regularly and amended as required.

The policies and procedures required under this subsection should consider the following broad factors for the purpose of achieving the most advantageous terms for all derivatives party orders:

- price;
- the speed of execution;
- the certainty of execution;
- the overall cost of the transaction, when costs are passed on to derivatives parties.

These factors are not intended to be exhaustive and a derivatives firm should consider all other facts and circumstances that may be applicable to their derivatives parties

Subsection 19(2) – Fair terms and pricing when acting as principal

Both the compensation component and the market value or price component of the derivative is relevant in determining whether the price for a derivatives party is fair and reasonable. A derivatives firm's policies and procedures must address both the market value of the derivative as well as the reasonableness of compensation.

In assessing the fairness and reasonableness of compensation, the derivatives firm should take into consideration all relevant factors, including the availability of the derivatives involved in the transaction, the expense of executing transaction to the derivatives firm including, when

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applicable, the costs to hedge the derivative firm's exposure, the value of the services rendered by the derivatives firm, the risks incurred by the derivatives firm and the amount of any other compensation received or to be received by the derivatives firm in connection with the transaction.

PART 4
DERIVATIVES PARTY ACCOUNTS

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The obligations in this Division do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 20 – Relationship disclosure information

Content of relationship disclosure information

There is no prescribed form for the relationship disclosure information required under section 20. A derivatives firm may provide this information in a single document, or in separate documents, which together give the derivatives party the prescribed information.

We would expect that relationship disclosure information would contain accurate, complete, and up-to-date information. We suggest that derivatives firms review their disclosures annually or more frequently, as necessary. A derivatives firm must take reasonable steps to notify a derivatives party, in a timely manner, of significant changes in respect of the relationship disclosure information that has been provided.

To satisfy their obligations under subsection 20(1), individuals acting on behalf of a derivatives firm must spend sufficient time with derivatives parties in a manner consistent with their operations to adequately explain the relationship disclosure information that is delivered to them. We expect a derivatives firm to have policies and procedures that reflect the derivatives firm's practices when preparing, reviewing, delivering and revising relationship disclosure documents.

Disclosure should occur before entering into an initial derivatives transaction, prior to advising a derivatives party in respect of a derivative and when there is a significant change in respect of the information delivered to a derivatives party. We expect that the derivatives firm will maintain evidence of compliance with their disclosure requirements.

Subsection 20(2) – Required relationship disclosure information

Description of the nature or type of the derivative party's account

Under paragraph 20(2)(a), a derivatives firm must provide derivatives parties with a description of the nature or type of account that the derivatives party holds with the derivatives firm. In

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particular, we would expect that a derivatives firm would provide sufficient information to enable the derivatives party to understand the manner in which transactions will be executed and any applicable contractual obligations. We would also expect a derivatives firm to provide information regarding margin and collateral requirements, if applicable, and disclose how the derivatives party assets will be held, used and invested. We would expect that the relationship disclosure information would also describe any related services that may be provided by the derivatives firm. If the firm is advising in derivatives, and the adviser has discretion over the derivatives party's account, we would also expect this to be disclosed

Identify the products or services the derivatives firm offers

Under paragraph 20(2)(b) a derivatives firm must provide a general description of the products and services the derivatives firm offers to a derivatives party. We would expect the relationship disclosure information to explain which asset classes the derivatives firm deals in and explain the different types of derivative products that the derivatives firm can transact with the derivatives party.

Describe the types of risks that a derivatives party should consider

We would expect a derivatives firm to provide an explanation of the risks associated with the derivatives products being transacted, including any specific risks relevant to the derivatives offered and strategies recommended to the derivatives party. While not exhaustive, transactions will involve one or more of the following risks: market, credit, liquidity, operational, legal and currency risk.

Describe the risks to a derivatives party of using leverage to finance a derivative

In addition to the disclosure prescribed by section 16, paragraph 20(2)(d) contemplates that a derivatives firm will disclose the risk of leverage to all derivatives parties, regardless of whether or not the derivatives party uses leverage or the derivatives firm recommends the use of borrowed money to finance any part of a transaction. Using leverage means that investors are only required to deposit a percentage of the total value of the investment when entering into a transaction. This effectively amounts to a loan by the derivatives firm to the derivatives party. However, the derivatives party's profits or losses are based on changes in value of the total investment. This means leverage magnifies a derivatives party's profit or loss on a transaction, and losses can exceed the amount of funds deposited.

Describe the conflicts of interest

Under paragraph 20(2)(e) a derivatives firm must provide a description of the conflicts of interest that the derivatives firm is required to disclose under securities legislation. One such requirement is in section 9 of the Instrument, which provides that a firm must take reasonable steps to identify and then respond to existing and potential material conflicts of interest between the derivatives firm and the derivatives party. This includes disclosing the conflict, where appropriate.

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Disclosure of charges and other compensation

Paragraphs 20(2)(f), (g) and (h) require a derivatives firm to provide a derivatives party information on fees and costs they might be charged when entering into a transaction in a derivative. These requirements ensure that a derivatives party receives all relevant information to evaluate the costs associated with the products and services they receive from the derivatives firm. We expect this disclosure to include information related to compensation or other incentives that the derivatives party may pay relating to a transaction.

At the outset of their relationship, a derivatives firm must provide the derivatives party with general information on any transaction and other charges that a derivatives party may be required to pay, as well as other compensation the derivatives firms may receive as a result of their business relationship. We recognize that a derivatives firm may not be able to provide all cost information regarding a particular transaction until the terms of the contract have been agreed upon. However, before entering into an initial transaction, a derivatives firm must meet the applicable pre-trade disclosure requirements in section 21 of the Instrument.

Description of content and frequency of reporting

Under paragraph 20(2)(i) a derivatives firm is required to provide a description of the content and frequency of reporting to the derivatives party. Reporting to derivatives parties includes, as applicable

- daily reporting under section 22,
- transaction confirmations under section 29, and
- derivatives party statements under section 30.

Further guidance about a derivatives firm's reporting obligations to a derivatives party is provided in Division 3 of this Part.

Know your derivatives party information

Paragraph 20(2)(l) requires a derivatives firm to disclose the type of information that it must collect from the derivatives party and explain how this information will be used in assessing and determining the suitability of a derivatives party transaction.

Section 21 – Pre-transaction disclosure

There is no prescribed form for the pre-trade disclosure that must be provided to a derivatives party under section 21. The derivatives firm may provide this information in a single document, or in separate documents which together give the derivatives party the prescribed information.

The disclosure document required under subsection 21(1) must be delivered to the derivatives party at a reasonably sufficient time prior to entering into the first transaction with the

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derivatives firm to allow the derivatives party to assess the material risks and material characteristics of the type of derivative transacted.

We consider a material risk that a derivatives firm is required under paragraph 21(1)(a) to disclose to a derivatives party to include market, credit, liquidity, foreign currency, legal, operational and any other applicable risks.

In addition to the requirement to provide a general disclosure document under subsection (1), we understand that the use of the term "price" is not always appropriate in relation to a transaction in a derivative. In paragraph 21(2)(b), we also expect disclosure with respect to spreads, premiums, costs, etc.

DIVISION 2 – DERIVATIVES PARTY ASSETS

The obligations in this Division, other than section 24 [*Interaction with NI 94-102*] and section 25 [*Segregating derivatives party assets*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

Section 25 – Segregating derivatives party assets

A derivatives firm is required to segregate derivatives party assets from its own property either by separately holding or accounting for derivatives party assets. Records maintained by a derivatives firm must make it clear that accounts holding derivative party assets are for the benefit of derivatives parties only.

Section 26 – Holding derivatives party assets

We expect that a derivatives firm would take reasonable efforts to confirm that the permitted depository holding the derivatives party assets

- qualifies as a permitted depository under the Instrument,

- has appropriate rules, policies and procedures, including robust accounting practices, to help ensure the integrity of the derivatives party assets and minimize and manage the risks associated with the safekeeping and transfer of the derivatives party assets,

- maintains securities in an immobilised or dematerialised form for their transfer by book entry,

- protects derivatives party assets against custody risk through appropriate rules and procedures consistent with its legal framework,

- employs a robust system that ensures segregation between the permitted depository's own property and the property of its participants and segregation among the property of participants, and where supported by the legal framework, supports operationally the

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segregation of property belonging to a derivative party on the participant's books and facilitates the transfer of derivatives party assets,

- identifies, measures, monitors, and manages its risks from other activities that it may perform, and

- facilitates prompt access to derivatives party assets, when required.

If a derivatives firm is a permitted depository, as defined in the Instrument, it may hold derivatives party assets itself and is not required to hold derivatives party assets at a third party depository. For example, a Canadian financial institution that acts as a derivatives firm would be permitted to hold derivatives party assets provided it did so in accordance with the requirements of the Instrument. Where a derivatives firm deposits derivatives party assets with a permitted depository, the derivatives firm is responsible for ensuring the permitted depository maintains appropriate books and records to ensure the derivatives party assets can be attributed to the derivatives party.

Section 27 – Use of derivatives party assets

The use of derivatives party assets attributable to a derivatives party to satisfy the obligations of any other party is not permitted.

Subsection 27(3) allows a derivatives firm to place a lien on derivatives party assets where the lien arises in connection with an obligation of the derivatives party. This exception recognizes that certain arrangements involve the granting of security interests in derivatives party assets. A derivatives firm is prohibited from imposing or permitting a lien that is not expressly permitted by the Instrument on derivatives party assets and should such an improper lien be placed on derivatives party assets, the derivatives firm must take all reasonable steps to promptly address the improper lien.

Section 28 – Investment of derivatives party assets

Although losses in the value of invested derivatives party assets are not to be allocated to a derivatives party, we are of the view that parties should be free to contract for the allocation of gains resulting from a derivatives firm's investment activities in accordance with the Instrument.

DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

The obligations in this Division, other than subsection 29(1) [*Content and delivery of transaction confirmations*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or an eligible derivatives party that is an individual that has waived these obligations.

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Section 29 – Content and delivery of transaction confirmations

We are of the view that the description of the derivative transacted required by paragraph 29(2)(a) would be fulfilled by providing a plain language description of the asset class of the derivative and the features of the derivative (e.g., fixed for floating interest swap with CDOR as reference rate, single name credit default swap).

Section 30 – Derivatives party statements

We are of the view that the description of the derivative transacted required by paragraphs 30(2)(b) and 30(3)(a) would be fulfilled by providing a plain language description of the asset class of the derivative and the features of the derivative (e.g., fixed for floating interest swap with CDOR as reference rate, single name credit default swap).

PART 5
COMPLIANCE AND RECORDKEEPING

DIVISION 1 – COMPLIANCE

Section 31 – Definitions

For the purposes of this Division 1 – *Compliance* of Part 5, a "derivative business unit" refers to an organizational unit or division of a derivatives firm that conducts derivatives activities. A derivatives firm may have one or more organizational divisions that conduct derivatives activities. For example, a firm may divide its derivatives activities based on asset class or geographic location of trading. A derivatives business unit may conduct activities in addition to over-the-counter (OTC) derivatives trading such as exchange-traded derivatives or securities activities.

For the purposes of this Division, "senior derivatives manager" refers to each individual who is principally responsible for managing one or more derivatives business units at a derivatives firm. For example, an individual responsible for, or head of, interest rate trading or the "rates desk" at a derivatives firm would be considered a senior derivatives manager. Depending on its size, level of derivatives activity and structure, a derivatives firm may have a number of different derivatives business units. A derivatives firm would be required to have a senior derivatives manager who fulfills the requirements of this Division in respect of each derivatives business unit. A senior manager may be responsible for multiple business units.

The definition of "senior derivatives manager" is intended to capture individuals who are directly responsible for specific lines of derivatives activity and therefore this would not necessarily be the Chief Executive Officer or Chief Compliance Officer of a derivatives firm.

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Section 32 – Policies and procedures

Section 32 requires a derivatives firm to establish, maintain and apply policies and procedures that establish a system of controls and supervision (i.e., a "compliance system") that provides assurance that the derivatives firm and those acting for it, as applicable, comply with applicable securities legislation, manage risks prudently, and possess the requisite education and training to perform these activities in a competent manner.

We would expect that a compliance system that is sufficient to meet the requirements of this section would include internal controls and monitoring systems that are reasonably likely to identify non-compliance at an early stage and supervisory systems that allow the firm to correct non-compliant conduct in a timely manner. As more requirements apply to a derivatives firm when transacting with or advising a person or company that is not an eligible derivatives party, the monitoring and compliance systems that are appropriate when transacting with or advising such person or company would be commensurately more comprehensive.

"Securities legislation" is defined in National Instrument 14-101 *Definitions*, and includes statutes and other instruments related to both securities and derivatives. We do not expect that the compliance system established in accordance with the Instrument would be applicable to activities other than a derivatives firm's derivatives activities. For example, a derivatives dealer may also be a reporting issuer. The compliance system established to monitor compliance with the Instrument would not necessarily be concerned with matters related only to the derivatives firm's status as a reporting issuer, though it would be acceptable to have a single compliance system related to the derivatives firm's compliance with all applicable securities laws.

The risks referred to in paragraph 32(b) include the risks inherent in derivatives trading (including credit risk, counterparty risk, and market risk), which relate to the derivatives firm's overall financial viability.

The proficiency requirement in paragraph 32(c) imposes on a derivatives firm a duty to ensure that individuals acting for the derivatives firm in relation to its derivatives activities possess the required education and training to ensure competency. The Instrument establishes a reasonableness standard rather than setting out specific courses or other training requirements. However, a derivatives firm may also be required to be registered in accordance with securities legislation; more specific training and experience requirements apply to such a derivatives firm and its representatives under that instrument.

While a certain amount of industry experience could substitute for formal education and training, we would expect that all individuals connected with trading in or advising on derivatives receive appropriate recurring training, at least annually.

Section 33 – Responsibilities of senior derivatives managers

A senior derivative manager's responsibilities under this Division apply to the senior derivative manager even in situations where that individual has delegated his or her responsibilities.

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The requirement on a senior derivative manager in paragraph 33(1)(c) to take reasonable steps to prevent material non-compliance with respect to derivatives activities conducted in his or her business unit includes both preventative steps and reactive steps where a senior derivatives manager has discovered material non-compliance. Where a senior manager becomes aware of material non-compliance in his or her business unit but does not take reasonable steps to address it, that senior derivatives manager would be in breach of the Instrument. A senior manager would also be in breach of the Instrument in terms of identifying and reporting non-compliance even if the senior manager has delegated responsibilities and has not been properly advised of the non-compliance.

Under section 33 of the Instrument, each senior derivatives manager of a derivatives firm must, at least once per calendar year, submit a report to the derivatives firm's board of directors

- certifying that the derivatives business unit is in material compliance with the Instrument, applicable securities legislation, and the policies and procedures of the derivatives firm under section 32, or

- specifying all circumstances where the derivatives business unit is not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm under section 32.

We would expect that in complying with this requirement the senior derivatives manager will exercise reasonable care in determining when and how often material non-compliance should be reported to the board. For example, in a case of serious misconduct we would expect the board to be made aware promptly.

We consider non-compliance with the Instrument, applicable securities legislation and the policies and procedures of the derivatives firm required under section 32 to be material if the non-compliance

- has, or could have, a negative impact on the interest of a derivatives party,

- results, or could result, in a material harm to the derivatives firm, including causing the derivatives firm to incur

    - a material financial loss, or

    - a material increase in their business or financial risk,

- was part of a pattern on non-compliance, or

- would constitute bad faith or fraud or would be an offence under applicable securities legislation.

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Section 34 – Responsibility of a derivatives firm to respond to material non-compliance

If a senior derivatives manager notifies the board of directors of a derivatives firm that his or her derivatives business unit is not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm under section 32, the derivatives firm must,

- respond to the specified non-compliance in a timely manner, and document its response, and

- report to the regulator or securities regulatory authority in a timely manner any circumstance where, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the Instrument, applicable securities legislation, or the policies and procedures of the derivatives firm required under section 32.

The obligation on the derivatives firm to make a report to the regulator under subsection 34(b) will depend on whether the specified non-compliance would reasonably be considered material non-compliance by the derivatives firm, with the Instrument, applicable securities legislation, or the policies and procedures required under section 32.

DIVISION 2 – RECORDKEEPING

Section 35 – Derivatives party agreement

Appropriate subject matter for the derivatives party agreement includes terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, governing law, valuation, and dispute resolution. We would expect that the agreement would also cover other areas as appropriate in the context of the transactions into which the parties will enter. For example, where transactions will be subject to margin, we would expect the agreement to cover margin requirements, assets that may be used, asset valuation methods, investment and rehypothecation terms, and custodial arrangements.

Section 36 – Records

Section 36 imposes a general obligation on a derivatives firm to keep full and complete records relating to the derivatives firm's derivatives, transactions in derivatives, and all of its business activities relating to derivatives, trading in derivatives or advising in derivatives. This list of records is not intended to be exhaustive but rather includes the records that must be kept, at a minimum. We would expect a derivatives firm to consider the nature of its derivatives-related activity when determining the records that it must keep and the form of those records.

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The general principle underlying section 36 is that a derivatives firm must document, through its records,

- compliance with all applicable securities legislation (including the Instrument),
- the details and evidence of the derivatives to which it has been a party or in respect of which it has been an agent,
- the circumstances surrounding the entry into and termination of those derivatives, and
- related post-trade matters.

We would, for example, expect a derivatives firm to be able to demonstrate, for each derivatives party, the details of compliance with the obligations in section 10 [*Know your derivatives party*] and, if applicable, the obligations in section 11 [*Derivatives-party-specific needs and objectives*] and section 12 [*Suitability*] (and if sections 11 and 12 are not applicable, the reason as to why it is not).

If a derivatives firm wishes to rely on any exemption or exclusion in the Instrument or other related securities laws, it should be able to demonstrate that it is entitled to rely on the exemption or exclusion.

With respect to records demonstrating the existence and nature of the derivatives firm's derivatives that are required to be kept pursuant to paragraph 36(b) and records documenting the transactions relating to the derivatives required to be kept pursuant to paragraph 36(c), we expect a derivatives firm to accurately and fully document every transaction it enters into. We expect a derivatives firm to maintain notes of communications that could have an impact on a derivatives party's account or its relationship with the derivatives firm. These communications may include oral communications and all e-mail, regular mail, fax and other written communications.

While a derivatives firm may not need to save every voicemail or e-mail, or to record all telephone conversations with every derivatives party, we do expect a derivatives firm to maintain records of all communications with a derivatives party relating to derivatives transacted with, for or on behalf of the derivatives party.

Section 37 – Form, accessibility and retention of records

Paragraph 37(1)(b) requires derivatives firms to keep their records in a safe location. This includes ensuring that no one has unauthorized access to information, particularly confidential derivatives party and counterparty information. We would expect a derivatives firm to be particularly vigilant if it maintains books and records in a location that may be accessible by a third party. In this case, we would expect the derivatives firm to have a confidentiality agreement with the third party.

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PART 6
EXEMPTIONS

The Instrument provides several exemptions from the requirements in the Instrument. If a person or company is exempt from a requirement in the Instrument, the individuals acting on its behalf are also exempt from the requirement on the same terms.

DIVISION 1 – EXEMPTIONS FROM THIS INSTRUMENT

Section 39 – Exemption for certain derivatives end-users

Section 39 provides an exemption from the requirements of the Instrument for a person or company that transacts in derivatives but does not engage in the activities set out in paragraphs (a) – (e). The intention of this exemption is to exclude from the application of the Instrument a person or company that uses derivatives in the course of their business but does not deal with or advise other derivatives parties. For example, a person or company that frequently and regularly transacts in derivatives to hedge business risk may qualify for this exemption. Typically, such a person or company would transact with a derivatives dealer who would be subject to the requirements of the Instrument. It would not be reasonable for a person or company who regularly quotes prices on derivatives to other derivatives parties to claim that they are an end-user hedging business activities.

Under paragraph 39(c), a person or company who regularly quotes prices at which they would be willing to transact in a derivative would not qualify for this exemption. This ineligibility applies even if the person or company does not make a two-way market in a derivative by publishing quotes to buy and quotes to sell a derivatives position at the same time. For example, a person or company who is only willing to take a long position in a derivative but regularly quotes prices to prospective counterparties would not qualify for this exemption.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Section 40 – Foreign derivatives dealers

General principle

Section 40 contemplates an exemption from the Instrument for foreign derivatives dealers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Instrument. This exemption applies to the provisions of the Instrument where the derivatives dealer is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix A opposite the name of the foreign jurisdiction. The foreign jurisdictions specified in Appendix A are determined on a jurisdiction-by-jurisdiction basis, and depend on a review of the laws and regulatory framework of the jurisdiction.

This exemption is only available where a foreign derivatives dealer is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix A and does

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not incorporate any exemption or discretionary relief granted to a foreign derivatives dealer in connection with the laws of the foreign jurisdiction. Where a foreign derivatives dealer relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix A, it will need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument.

Conditions

This exemption is only available where the foreign derivative dealer is dealing with persons or companies that are eligible derivatives parties. The foreign derivatives dealer must also comply with each of the requirements under section 40. Furthermore, there may be "residual" provisions of the Instrument listed in Appendix A which must be complied with even if a foreign derivatives dealer is in compliance with the laws of a foreign jurisdiction set out in Appendix A.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Section 44 – Foreign derivatives advisers

General principle

Section 44 contemplates an exemption from the Instrument for foreign derivatives advisers that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Instrument. This exemption applies to the provisions of the Instrument where the derivatives adviser is subject to and in compliance with the laws of a foreign jurisdiction set out in Appendix D opposite the name of the foreign jurisdiction. The foreign jurisdictions specified in Appendix D are determined on a jurisdiction-by-jurisdiction basis, and depend on a review of the laws and regulatory framework of the jurisdiction.

This exemption is only available where a foreign derivatives adviser is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix D and does not incorporate any exemption or discretionary relief granted to a foreign derivatives adviser in connection with the laws of the foreign jurisdiction. Where a foreign derivatives adviser relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix D, it will need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument.

Conditions

This exemption is only available where the foreign derivative adviser is dealing with persons or companies that are eligible derivatives parties. The foreign derivatives adviser must also comply with each of the requirements under section 44. Furthermore, there may be "residual" provisions of the Instrument listed in Appendix D which must be complied with even if a foreign derivatives adviser is in compliance with the laws of a foreign jurisdiction set out in Appendix D.

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ANNEX III

LOCAL MATTERS

There are no local matters in Alberta to consider at this time.

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August 15, 2017

VIA ELECTRONIC MAIL

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

c/o:
Me Anne-Marie Beaudoin
Corporate Secretary
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c/o:
Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
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Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy

Dear Sir or Madam:

I. INTRODUCTION

On behalf of The Canadian Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP hereby submits this letter in response to the request for public comment from the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("**Proposed NI 93-101**") and the related Proposed Companion Policy ("**Proposed Companion Policy**") (collectively, the "**Proposed Instrument**").[1] The Working Group appreciates the CSA's

[1] *See* CSA Notice and Request for Comment on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy (Apr. 4, 2017) ("**CSA Notice**"), http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA_Notice_and_Request_for_Comment_NI_93-101.PDF.

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ongoing hard work throughout the derivatives regulatory reform process and offers these comments to further advance that process. The Working Group's comments are from the perspective of derivatives end-users who (i) would like clarity on the regulatory status of market participants and (ii) are concerned that undue burdens placed on derivatives dealers may result in higher costs for end-users and fewer available counterparties with whom they can hedge their commercial risk.

The Working Group is a diverse group of commercial firms that are active in the Canadian energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. The Working Group considers and responds to requests for comment regarding developments with respect to the trading of energy commodities, including derivatives, in Canada.

II. COMMENTS OF THE WORKING GROUP

A. The Scope of the Definition of "Derivatives Dealer" Should Be Made Clear.

The Proposed Instrument would impose business conduct obligations on "derivatives dealers." However, the scope of the proposed derivatives dealer definition is unclear and potentially overly broad.

Under Proposed NI 93-101, a "derivatives dealer" is defined as:

- "a…company engaging in or holding…itself out as engaging in the business of trading in derivatives as principal or agent"; or
- "any other…company required to be registered as a derivatives dealer under the securities legislation of a jurisdiction of Canada."[2]

Proposed NI 93-101's derivatives dealer definition is generally consistent with the definition of "derivatives dealer" used in the various derivatives reporting rules in Canada.[3]

However, the Proposed Companion Policy appears to expand the proposed derivatives dealer definition beyond the related reporting definitions as it states that the definition also

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[2] Proposed NI 93-101 at Section 1(1).

[3] *See*, *e.g.*, the "derivatives dealer" definition in the following:

- Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* ("**MI TR Rule**") (unofficial consolidated version of Sept. 30, 2016), http://www.albertasecurities.com/Regulatory%20Instruments/5315724-96-101_MI_Consolidation_Eff_September_30_2016.pdf; MI TR Rule Companion Policy (unofficial consolidated version of Sept. 30, 2016), http://www.albertasecurities.com/Regulatory%20Instruments/5315725-v1-96-101_CP_Consolidation_Eff_Sep_30_2016.pdf; and
- OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* ("**OSC TR Rule**") and the OSC TR Rule Companion Policy (unofficial consolidated version of July 29, 2016), http://www.osc.gov.on.ca/documents/en/Securities-Category9/rule_20160729_91-507_unofficial-consolidation-derivatives-data-reporting.pdf.

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captures entities "exempted from the requirement to be registered in [a] jurisdiction."[4] This language could have a myriad of implications.

For example, if the CSA, as the Ontario Securities Commission indicated, only intended to capture entities that are exempt from registration as a derivatives dealer in a province because they are subject to regulation or otherwise registered in that province, then the language is necessary to ensure uniform application of the business conduct standards in the Proposed Instrument.[5] However, if the language is intended to apply the requirements of the Proposed Instrument on entities that are otherwise exempt from registration as a derivatives dealer, such as under a potential *de minimis* exemption,[6] then the language could severely limit the efficacy of any such exemption as the costs imposed on otherwise exempt dealers could be significant.

The full extent of the implications of capturing entities that are "exempted from registration" as derivatives dealers under the Proposed Instrument is hard to evaluate in the absence of derivatives dealer registration rules. The Working Group appreciates the fact that the CSA plans on providing market participants the opportunity to comment on the Proposed Instrument in conjunction with the comments provided on its forthcoming registration proposal.[7] The Working Group urges the CSA to ensure that any exemptions from registration as a derivatives dealer, other than exemptions that allow entities to avoid registration in multiple jurisdictions, provided in the forthcoming registration proposal work in harmony with the Proposed Instrument. That is to say, exemptions from registration should allow market participants relying on those exemptions to avoid being treated as derivatives dealers under the Proposed Instrument.

B. Regularly Providing Quotes Is Not Indicia of Being a Derivatives Dealer.

The Proposed Companion Policy sets out the factors that would be used to determine whether a market participant has a business purpose for trading in derivatives and is, thus, a derivatives dealer. One of those factors is whether an entity "makes a two-way market in a derivative or routinely quotes prices at which [it] would be willing to transact in a derivative or offers to make a market in a derivative or derivatives."[8] However, the Canadian Working Group respectfully notes that regularly providing quotes is not necessarily indicia of being a derivatives dealer.

Section 39 of Proposed NI 93-101 uses almost the same language as a criterion on whether an entity qualifies for the proposed end-user exemption (*i.e.*, an entity that makes a

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[4] *See* Proposed Companion Policy at Section 1 (CSA Notice at 57).

[5] *See* Transcript of OSC Roundtable on the Proposed Instrument at 10 (May 29, 2017), http://www.osc.gov.on.ca/documents/en/Securities-Category9/oth_20160529_93-101_transcript-roundtable.pdf.

[6] Attached hereto as **Exhibit I** is the Working Group's White Paper, *The Need for a De Minimis Exception from Registration as a Derivatives Dealer in Canadian Provinces and Proposed Approaches for Implementation*.

[7] *See* CSA Staff Notice 93-301 *Derivatives Business Conduct Rule – No Overlap with Derivatives Registration Rule Comment Period* (June 15, 2017), http://www.albertasecurities.com/Regulatory%20Instruments/5353080%20_%20CSA_Staff_Notice_93-301.pdf; *see also* Transcript of OSC Roundtable on the Proposed Instrument at 76.

[8] *See* Proposed Companion Policy at Section 1 (CSA Notice at 57).

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two-way market or routinely quotes prices would not qualify for the exemption). The Proposed Companion Policy expands on that language by stating:

> It would not be reasonable for a…company who regularly quotes prices on derivatives to other derivatives parties to claim that [it is] an end-user hedging business activities…. A…company who regularly quotes prices at which [it] would be willing to transact in a derivative would not qualify for [the end-user exemption]. This ineligibility applies even if the…company does not make a two-way market in a derivative…. For example, a…company who is only willing to take a long position in a derivative but regularly quotes prices to prospective counterparties would not qualify for [the end-user exemption].[9]

The assumption made in the Proposed Companion Policy that an entity that regularly quotes prices, even if those quotes are limited to one side of the market, cannot be hedging is false.

For example, many energy companies have assets (*e.g.*, power plants, crude oil inventory, pipelines) that require active hedging. Those assets typically leave an energy company with a natural exposure on one side of the market. For example, the owner of a natural gas fired power plant is inherently short natural gas and a crude producer is inherently long crude oil. To ensure that it is getting the best price for its hedges, it would not be uncommon for that power plant owner to regularly provide quotes or indicative pricing on long natural gas derivatives or for the crude oil producer to do the same on short crude oil derivatives.

Moreover, there are instances where an end-user may take an opposing position to its natural hedging position due to a variety of reasons, including active hedge management in the form of unwinding of previously executed positions. In addition, in the case of unanticipated events, such as unplanned maintenance at a refinery, an end-user might be on one side of the market in the current month unwinding existing hedges and on the other side of the market executing its long-term hedging strategy.

Finally, entities that engage in proprietary trading might provide quotes on both sides of the market, but at a spread that represents a true market view, unlike the circumstance of market makers who are typically agnostic to the direction of price movements. For example, a trader that believes the price of crude oil is going up to $50 a barrel still might provide a price at which the trader is willing to sell if the price is right.

Therefore, the CSA should revise its guidance to note that entities that regularly provide quotes on one side of the market are not market makers or derivatives dealers and should not be treated as such. Further, the CSA should revise its guidance on what activity constitutes market making for the purposes of the derivatives dealer definition to capture entities acting as true market makers by regularly providing two-way quotes that are generally agnostic to price movements.

C. The Scope of the Definition of "Eligible Derivatives Party" Should Be Made Consistent with Existing Derivatives Regulations.

i. The Definition of "Eligible Derivatives Party" Should Account for Market Participants Who Use Derivatives to Manage Physical Commodity Risk.

The Proposed Instrument attempts to separate the derivatives market into two groups – (i) sophisticated market participants and (ii) less sophisticated market participants – under

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9 Proposed Companion Policy at Section 39 (CSA Notice at 88).

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the theory that the latter group requires extra customer protections. This is clearly appropriate where a retail customer lacks the expertise to be able to critically evaluate the products being presented. The mechanism by which the Proposed Instrument seeks to differentiate between the two groups is the definition of "eligible derivatives party" ("**EDP**"). The Proposed Instrument would impose fewer business conduct obligations on a derivatives dealer for its transactions with an EDP than for its transactions with a counterparty that does not meet the definition of "eligible derivatives party" ("**Non-EDP**").[10] However, as currently constructed, the mechanism by which the Proposed Instrument seeks to separate the two groups of market participants may work for certain derivatives markets, but it does not appropriately account for the level of sophistication of commodity derivatives market participants.

In derivatives markets, applying different levels of regulation based on the level of sophistication of market participants is common. For example, various provinces' existing blanket orders (collectively, the "**Exemption Blanket Orders**"),[11] among other things, effectively exempt market participants from the obligation to register as derivative dealer if they limit their derivatives counterparties to "qualified parties." Section 7 of the Quebec Derivatives Act takes a similar approach by excluding transactions between "accredited counterparties"[12] from consideration when determining whether an entity must register as a derivatives dealer. Further, in the United States, the Commodity Exchange Act ("**CEA**") requires market participants to be "eligible contract participants" in order to enter into swaps.[13] The CSA notes that the EDP definition is generally consistent with the definition of: "qualified party" in the Exemption Blanket Orders; "accredited counterparty" under the Quebec Derivatives Act; and "eligible contract participant" under the Commodity Futures Trading Commission's ("**CFTC**") rules.[14] However, the Proposed Instrument's definition of "eligible derivatives party" is different in a few meaningful ways, as discussed further below.

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10 *See* CSA Notice at 3-4; *see also* CSA Notice at Appendix B.

11 *See* Alberta Securities Commission Blanket Order 91-507 *Over-the-Counter Derivatives* (Jan. 23, 2017), http://www.albertasecurities.com/Regulatory%20Instruments/5330057%20_%2091-507_OTC_Trades_in_Derivatives.pdf; British Columbia Securities Commission Blanket Order 91-501 *Over-the-Counter Derivatives* (Nov. 24, 1999), https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/91-501__BCI_/; Financial and Consumer Services Commission (New Brunswick) Local Rule 91-501 *Derivatives* (consolidated up to Jan. 11, 2015), http://www.nbsc-cvmnb.ca/nbsc/uploaded_topic_files/91-501-LR-CONS-2015-01-11-E.pdf; Nova Scotia Securities Commission Blanket Order 91-501 *Over the Counter Trades in Derivatives* (Feb. 17, 2016), https://nssc.novascotia.ca/sites/default/files/docs/Blanket%20Order%2091-501%20Feb%2017%202016%20OTC%20Derivaties.pdf; Financial and Consumer Affairs Authority of Saskatchewan General Order 91-908 *Over-the-Counter Derivatives* (Feb. 29, 2016), http://www.fcaa.gov.sk.ca/Default.aspx?DN=2fd89016-0cc1-41ca-9fab-91c69487703f.

12 *See* Quebec Derivatives Act at Section 3 (defining "accredited counterparty"), https://www.canlii.org/en/qc/laws/stat/cqlr-c-i-14.01/latest/cqlr-c-i-14.01.html#sec3_smooth.

13 *See* CEA Section 2(e).

14 CSA Notice at 5.

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The definition of "qualified party,"[15] "accredited counterparty,"[16] "eligible contract participant," and "eligible derivatives party" provide an asset threshold that an entity that is not otherwise captured under the definition must exceed to satisfy the definition. For example, an entity that is not otherwise captured under the definition must have $10 million in total assets to qualify as an eligible contract participant or have $25 million in total assets to qualify as a qualified party.[17] The Proposed Instrument has a similar, though more stringent, threshold in the EDP definition – **net** assets of at least $25 million.[18]

Further, the definition of "qualified party" and "accredited counterparty" allow commodity market participants that are managing their physical business to satisfy the definition without any asset qualification test.[19] In the case of the definition of "eligible contract participant," an entity may meet that definition if it has a net worth of over $1 million and enters into a swap to hedge commercial risk.[20] The definition of "eligible derivatives party" does not have similar provisions.

The lower standard for entities that are managing risks associated with their physical business likely reflects two important drivers. *First*, risk management through the use of derivatives should be encouraged. *Second*, the relative sophistication even smaller market participants have if their day-to-day business is dependent on a physical commodity. For example, a small crude oil producer is much more likely to have the knowledge to evaluate the suitability of a hedge of its oil production than a small manufacturer looking to hedge foreign currency or interest rate risk.

The CSA may see a benefit in a narrower definition of "eligible derivatives party" because more market participants would enjoy extra customer protections. However, imposing additional customer protections on trading relationships with certain classes of market participants can in fact harm the entities that regulators seek to protect. This is especially true in smaller markets with fewer market participants, such as commodity derivatives markets.

With respect to the Proposed Instrument, the additional customer protections imposed on trading relationships with Non-EDPs are costly. At least a portion of those additional costs are likely to be passed along to Non-EDPs in the form of fees or higher prices. In addition, as many of the additional costs are not purely variable costs attributable to a particular transaction, derivatives dealers will have to make a conscious investment in compliance infrastructure to serve Non-EDPs, which could leave certain markets, like energy derivatives

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[15] *See*, *e.g.*, ASC Blanket Order 91-507 (paragraph s of the qualified party definition); BCSC Blanket Order 91-501 (paragraph s of the qualified party definition); FCSC NB Local Rule 91-501 (paragraph l of the qualified party definition); NSSC Blanket Order 91-501 (paragraph s of the qualified party definition); FCAA Saskatchewan General Order 91-908 (paragraph s of the qualified party definition).

[16] *See*, *e.g.*, Quebec Derivatives Act (paragraph 7(b) of the accredited counterparty definition); Quebec Derivatives Regulation at Section 1, https://www.canlii.org/en/qc/laws/regu/cqlr-c-i-14.01-r-1/latest/cqlr-c-i-14.01-r-1.html.

[17] *See* CEA Section 1a(18); ASC Blanket Order 91-507 at 4.

[18] *See* Proposed NI 93-101 at Section 1.

[19] *See* ASC Blanket Order 91-507 (paragraph p of the qualified party definition); BCSC Blanket Order 91-501 (paragraph p of the qualified party definition); FCSC NB Local Rule 91-501 (paragraph q of the qualified party definition); NSSC Blanket Order 91-501 (paragraph p of the qualified party definition); FCAA Saskatchewan General Order 91-908 (paragraph p of the qualified party definition, and page 5); Quebec Derivatives Act (paragraph 12 of the accredited counterparty definition).

[20] *See* CEA Section 1a(18); CFTC Regulation 1.3(m).

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markets, with a limited number of dealers, all of which are affiliated with large financial institutions capable of making the investment necessary to comply with requirements of the Proposed Instrument.

Therefore, the Working Group respectfully requests that the CSA amend the proposed definition of "eligible derivatives party" so that it is consistent with the definition of "qualified party" and "accredited counterparty." Specifically, the "eligible derivatives party" definition should be revised so that it includes:

> "a person or company that buys, sells, trades, produces, markets, brokers or otherwise uses a commodity in its business and that executes an over-the-counter trade in a derivative provided that a material component of the underlying interest of the derivative is any of the following:
>
> (i) a commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (ii) a commodity, security or variable that directly or indirectly affects the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (iii) a commodity, security or variable for which there is a high degree of correlation between the movement in its value and the movement in the value of the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (iv) another derivative which is not listed for trading on an exchange, where a material component of the underlying interest of that other derivative is a commodity, security or variable referred to in any of subparagraphs (i) to (iii)."

In the alternative, the CSA could provide entities hedging physical commodity risk associated with their commercial business with a significantly lower asset threshold (*e.g.*, $1 million) to qualify as an EDP.

Or, the CSA could allow commercial entities engaged in hedging activity to affirmatively represent that they are qualified to evaluate the risks associated with derivatives transactions and "opt in" to being treated as an EDP if they would not otherwise qualify as such. This approach would be similar to the approach taken by the CFTC.[21] For example, the CSA could amend the Proposed Instrument to include the following language as a new Section 8.[22]

> "8. The requirements of this Instrument, other than the requirements specified in Section 7(1), do not apply to a derivatives firm in respect of a derivatives party who is not an eligible derivatives party and that is not an individual if:
>
> (a) the non-eligible derivatives party, or an agent to which such non-eligible derivatives party has delegated decision-making authority, represents in

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21 *See*, *e.g.*, CFTC Regulation 23.434(b).

22 The implementation of the Working Group's proposed new Section 8 could be done in a manner similar to Schedule 3 Part II of the ISDA August 2012 DF Supplement, which implements the provisions in CFTC Regulation 23.434(b)(2). *See* ISDA August 2012 DF Supplement (Published Aug. 13, 2013), http://www2.isda.org/attachment/NDc5Mg==/ISDA%20August%202012%20DF%20Supplement_Publication.pdf.

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writing that it is capable of independently evaluating investment risks with regard to the relevant transactions or trading strategy involving a derivative;

(b) the non-eligible derivatives party or its agent represents in writing that it is exercising independent judgment in evaluating the recommendations of the derivatives firm with regard to the relevant transactions or trading strategy involving a derivative; and

(c) the derivatives firm discloses in writing that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of the transaction or trading strategy involving a derivative for the counterparty."

ii. The Definition of "Eligible Derivatives Party" Should Allow for the Use of Guarantees.

The definition of "eligible derivatives party" should allow an entity to qualify as such if it is guaranteed by an affiliate that is an EDP. In many circumstances, a commercial energy company will have project entities created to house a particular project, like a wind farm or central hedging entities that face the market on behalf of affiliates. These entities may not have the $25 million in net assets needed to qualify as an EDP, but, in many cases, receive credit support from an affiliate that is an EDP.

The Working Group respectfully requests that the CSA amend the definition of "eligible derivatives party" to allow an entity to rely on a guarantee of an affiliated EDP to qualify as such. Doing so would be consistent with the CFTC's approach to the definition of "eligible contract participant."[23]

iii. Representations as to Capability with Respect to the Eligible Derivatives Party Definition Should Be Permitted in Master Agreements.

To qualify as an EDP under part (m) of that definition, a company must represent "that it has the requisite knowledge and experience to evaluate the information provided to [it] about derivatives, the suitability of the derivatives for that…company." The Working Group would like the CSA to confirm that such representations could be made in a master trading agreement or protocol amending existing master trading agreements and deemed repeated for each transaction under the relevant master trading agreement.[24]

Further, the Working Group appreciates that the Proposed Companion Policy would allow a derivatives dealer to rely on its counterparty's representation as to its EDP status. Specifically, the Proposed Companion Policy states that a derivatives dealer "may rely on factual representations made in writing by the derivatives party [as to its status as an EDP], unless a reasonable person would have grounds to believe that such statements are false or it is otherwise unreasonable to rely on the representation."[25]

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[23] *See* CEA Section 1a(18)(v)(II).

[24] Such an approach would be akin to the approach taken in Schedule 3 Part II of the ISDA August 2012 DF Supplement. *See* ISDA August 2012 DF Supplement (Published Aug. 13, 2013). Schedule 3 Part II of the ISDA August 2012 DF Supplement implements the provisions in CFTC Regulation 23.434(b)(2).

[25] *See* Proposed Companion Policy at Section 1 (CSA Notice at 60).

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However, the Proposed Companion Policy seemingly undoes this reasonable approach by suggesting that in determining whether it is reasonable to rely on a representation as to EDP status, the following factors may be considered:

- whether the derivatives party enters into transactions with frequency and regularity;
- whether the derivatives party has staff who have experience in derivatives and risk management;
- whether the derivatives party has retained independent advice in relation to its derivatives; and
- publically available financial information.[26]

This seems to indicate that active investigation by a derivatives dealer is required to determine whether a representation as to EDP status can be relied upon. This may not have been the CSA's intent as obligating derivatives dealers to investigate a counterparty's representations as to EDP status would place a significant burden on derivatives dealers, and, consequently, their counterparties. Requiring affirmative investigation would also delay execution for what can be quite time sensitive transactions. The Working Group respectfully requests for the CSA to clarify that unless a derivatives dealer has information in its possession (*e.g.*, financial statements) that raise material questions with respect to a counterparty's status as an EDP, the derivatives dealer should be permitted to rely on a counterparty's representation as to its status as an EDP.

D. The End User Exemption Should Be Amended to Avoid Harming Commodity Derivatives Markets.

The Working Group appreciates that the CSA included a bright-line end-user exemption from the obligations of the Proposed Instrument. With two modifications, the proposed end-user exemption would provide the CSA's desired relief and would avoid potential unintended consequences that could be detrimental to commodity derivatives markets.

First, the CSA should permit end-users that transact derivatives with Non-EDPs to qualify for the end-user exemption. By including a requirement that an entity not transact with Non-EDPs to qualify for the end-user exemption, the CSA is creating the inference that transacting with those entities is indicia of being a derivatives dealer, especially when the other criteria to qualify for the proposed end-user exemption relate to factors the CSA has identified as relevant when determining if an entity is a derivatives dealer.[27] In short, the end-user exemption in the Proposed Instrument functions like an exemption from the definition of "derivatives dealer."

Given that the consequences of being a derivatives dealer will likely be significant under both the Proposed Instrument and in other circumstances, many commercial market participants will likely attempt to qualify for the proposed end-user exemption to provide themselves bright-line comfort that they are not a derivatives dealer. In commodity derivatives markets, if the end-user exemption is finalized as proposed, this may cause

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[26] *See* Proposed Companion Policy at Section 1 (CSA Notice at 60).

[27] The criteria to qualify for the exemption in Section 39 of Proposed NI 93-101 mirrors the factors for determining whether an entity is a derivatives dealer under Section 1 of the Proposed Companion Policy (CSA Notice at 57-58).

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Non-EDPs to lose a number of available counterparties. When coupled with the increased compliance burdens for derivatives dealers that transact with Non-EDPs discussed above, Non-EDPs in commodity derivatives markets may find their universe of potential counterparties limited to just the largest financial institutions. This may result in reduced market liquidity and increased transaction costs generally.

Second, as noted above in Section II.B, the proposed end-user exemption would not be available to entities that "regularly quote prices at which they would be willing to transact in a derivative."[28] As discussed in Section II.B, the assumption made in the Proposed Companion Policy that an entity that regularly quotes prices on one or both sides of the market cannot be hedging is false. Therefore, the end-user exemption should be available to entities even if they regularly provide quotes on one or both sides of the market.

If the end-user exemption were unavailable to market participants, such as the power plant owner in the example above, it may cause certain market participants to significantly reduce the degree to which they interact with derivatives markets, potentially harming price transparency and liquidity. Therefore, the Working Group suggests that the CSA clarify that the end-user exemption is not available to entities that act as market makers and is available to other entities that actively participate in derivatives markets for their commercial needs.

E. Imposition of Compliance Responsibility on Senior Derivatives Managers Is Inconsistent with Best Practice.

The Proposed Instrument would impose certain high-level requirements on "senior derivatives managers."[29,30] A senior derivatives manager would be required to "supervise the activities conducted in his or her derivatives business unit that are directed towards ensuring compliance" with applicable law.[31] A senior derivatives manager would also be obligated to promote compliance and take reasonable steps to prevent and address any non-compliance.[32] A senior derivatives manager would be permitted to delegate this responsibility, but would remain responsible if the senior manager has delegated responsibilities and has not been properly advised of any non-compliance.[33] In addition, under the Proposed Instrument, each senior derivatives manager would have to, on an annual basis, provide a report to the board of directors of the derivatives dealer (i) certifying that the relevant derivatives business unit

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[28] Proposed NI 93-101 at Section 39; *see also* Proposed Companion Policy at Section 39 (CSA Notice at 88), which notes that:

> It would not be reasonable for a...company who regularly quotes prices on derivatives to other derivatives parties to claim that [it is] an end-user hedging business activities.... A...company who regularly quotes prices at which [it] would be willing to transact in a derivative would not qualify for [the end-user exemption]. This ineligibility applies even if the...company does not make a two-way market in a derivative.... For example, a...company who is only willing to take a long position in a derivative but regularly quotes prices to prospective counterparties would not qualify for [the end-user exemption].

[29] "Senior derivatives manager" "means, in respect of a derivatives business unit..., the individual designated...as responsible for directing the derivatives activities of that unit." Proposed NI 93-101 at Section 31. "Derivatives business unit" is defined as "an organizational unit that transacts in...a derivative, or a class of derivatives." Proposed NI 93-101 at Section 31.

[30] Proposed NI 93-101 at Section 33.

[31] Proposed NI 93-101 at Section 33.

[32] Proposed NI 93-101 at Section 33.

[33] *See* Proposed Companion Policy at Section 33 (CSA Notice at 85).

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is in material compliance and (ii) identifying all instances where the derivatives business unit was not in material compliance.[34]

Imposing the proposed compliance obligations on senior derivatives managers is inconsistent with best practice. The Proposed Instrument would effectively designate the senior business person in charge of a derivatives desk or group as a compliance officer. Typically, a person in charge of overseeing a line of business is not also in charge of overseeing compliance for that line of business because of the inherent conflict of interest. In fact, best practice is that compliance functions report up outside the authority of the managers of the business they oversee.[35] Said another way, compliance functions should be independent of the business they oversee. The SIFMA White Paper addressing the appropriate role of compliance made that clear. SIFMA stated:

> In allocating duties, firms must protect Compliance's independence in order to mitigate conflicts of interest and exposure to potential liability. For instance, Compliance's advice should not be subject to the approval of senior management, Compliance personnel should be solely responsible for accomplishing Compliance-oriented tasks, rather than requiring such tasks to be performed in tandem with business personnel, and Compliance should have sufficient tools and expertise (including, as necessary, technology or business experts) to fulfill its responsibilities.[36]

That is not to say that senior business management do not have an important role to play with respect to compliance. Their role should be to set the tone and expectation of a culture of compliance. In this respect, the SIFMA White Paper stated "senior management has always been, and remains, responsible for setting a 'tone at the top' demonstrating that compliance is to be taken seriously and that all employees must play an active role in sustaining a 'culture of compliance' in a firm."[37] However, imposing actual compliance obligations on business line management could reduce the efficacy and independence of a company's compliance function.

Therefore, the Working Group requests that the CSA remove Section 33 of the Proposed Instrument. In alternative, the CSA could assign the responsibilities set forth in Section 33 of the Proposed Instrument to a senior compliance officer.

F. The Proposed Instrument's Recordkeeping Requirements Are too Broad.

The Proposed Instrument's recordkeeping requirements are overly broad and likely very burdensome. The Proposed Instrument appears to obligate derivatives dealers to capture and retain records of all derivatives customer facing interactions, including e-mail, instant message, and phone recordings, among other records.[38] The Proposed Instrument seems to place an affirmative obligation on derivatives dealers to record phone lines as well.[39]

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[34] *See* Proposed NI 93-101 at Section 33.

[35] *See* Securities and Financial Markets Association White Paper, *The Evolving Role of Compliance* at 17 (March 2013) ("**SIFMA White Paper**"), http://www.sifma.org/issues/item.aspx?id=8589942363.

[36] SIFMA White Paper at 6.

[37] SIFMA White Paper at 3.

[38] *See* Proposed Companion Policy at Section 36 (CSA Notice at 87).

[39] *See* Proposed Companion Policy at Section 36 (CSA Notice at 87).

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The Working Group appreciates that the CSA, in the Proposed Companion Policy, attempted to mitigate the burden potentially imposed by Proposed NI 93-101's recordkeeping requirements by stating "a derivatives [dealer] may not need to save every voicemail or e-mail, or to record all telephone conversations with every [counterparty]."[40] However, the Proposed Companion Policy goes on to state that the CSA does "expect a derivatives [dealer] to maintain records of all communications with a [counterparty] relating to derivatives transacted with…the [counterparty]."[41] Unfortunately, in most circumstances, it may actually be more burdensome to distinguish between communications covered by the Proposed Instrument's recordkeeping requirements and those that are not than just capturing all phone calls, instant messages, and e-mails attributed to particular trader. In addition, the proposed recordkeeping standard goes beyond keeping records related to the execution and negotiation of trades. The standard could be read to cover all back office activities related to derivatives activity, which are largely mechanical in nature, and the burden associated with keeping such records would not be offset by the minimal probative value to regulators provided by those records.

The Working Group respectfully suggests that the CSA clarify that derivatives dealers are only obligated to retain records of communications related to the negotiation of derivatives, the execution of derivatives, and any amendment or termination of derivatives. Further, the Working Group respectfully requests for the CSA to clarify that in the event such communication is made over the phone, that the recordkeeping requirement would be satisfied if a record of the communication was made and that recording phone lines would not be required to fulfill the recordkeeping requirement if a record of the communication otherwise exists.

G. Technical Comments on the Business Conduct Standards.

The Working Group has a few technical comments and questions on the particularities of the proposed business conduct standards.

First, the Proposed Companion Policy identifies as a potential conflict the circumstance where a derivatives dealer is "acting as an intermediary on behalf of an eligible derivatives party…when entering into a derivative as principal."[42] The Proposed Companion Policy goes on to say that those circumstances may not represent a conflict of interest "where the derivatives party is reasonably aware that derivatives firm is negotiating the derivative as a commercial arrangement."[43] The Working Group would like the CSA to confirm that a representation to that affect in a master trading agreement would be sufficient to address any potential conflict of interest.

Second, Section 10(4) of Proposed NI 93-101 would require a derivatives dealer to "take reasonable steps to keep the information required under this section [Know Your Derivatives Party] current." The Working Group would like the CSA to confirm that an annual request to counterparties from the derivatives dealer to update the relevant information would be sufficient to satisfy this requirement. An obligation to update the relevant information at any greater frequency would place an unnecessary burden on both the derivatives dealer and its counterparties.

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[40] Proposed Companion Policy at Section 36 (CSA Notice at 87).

[41] Proposed Companion Policy at Section 36 (CSA Notice at 87).

[42] Proposed Companion Policy at Section 9 (CSA Notice at 66).

[43] Proposed Companion Policy at Section 9 (CSA Notice at 66).

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Third, Section 32 of Proposed NI 93-101 requires a derivatives dealer to "ensure that individuals that perform an activity relating to transacting in or advising on derivatives have, on an ongoing basis, the experience, the education and the training that a reasonable person would consider necessary to perform that activity competently, including understanding the structure, features and risks of each derivatives that the individual transacts in or recommends." The Working Group would like the CSA to confirm that a training program which includes an annual compliance training, periodic sessions on fundamentals of relevant markets, and training on any new products in which a derivatives dealer begins to trade would be sufficient to satisfy this requirement.

Fourth, the Proposed Instrument's recordkeeping requirements might be clarified with respect to the use of the defined terms "transaction"[44] and "derivative."[45] For example, Section 36 of Proposed NI 93-101 provides a general requirement that a derivatives dealer retain "complete records" of all its derivatives and transactions, and Section 36(b) requires the retention of "documents provided to derivatives parties to confirm the derivative and their terms and each transaction relating to the derivative." Section 36(d) then goes on to require the retention of records of "post-transaction processing and events" including "transaction confirmations, terminations of derivatives, novations of derivatives, amendments to derivatives, and assignment of derivatives or rights under derivatives." These post-transaction events (other than confirmations) are in fact defined as transactions themselves and transactions are already covered by the recordkeeping requirements of Section 36, and it is unclear how post-transaction events relate to transactions if they are transactions themselves.

In addition, the requirement in Section 36(d) to retain confirmations is arguably redundant to the obligation to retain documents provided to confirm the derivative in Section 36(b). To the extent the CSA would like derivatives dealers' unexecuted confirmations provided to counterparties and executed confirmations, that should be made clear. However, the Working Group believes that retention of the executed confirmation should be sufficient as that is the confirmed understanding of the terms of a derivative.

Fifth, the proposed foreign dealer exemption in Section 40 of the Proposed Instrument requires that certain disclosures be made to Canadian counterparties. The Working Group would like the CSA to confirm that those disclosures can be made in a master trading agreement.

Sixth, it is unclear to the Working Group what Section 40(3)(e) of Proposed NI 93-101 is intended to address. Specifically, to qualify for the foreign dealer exemption, a market participant cannot be "in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in the jurisdiction."[46] While it is unclear which jurisdiction is being referred to, the Working Group understands this provision to prohibit entities that are market makers on an exchange or a derivatives trading facility in a particular Canadian jurisdiction from qualifying for the foreign dealer exemption in that same Canadian

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[44] "Transaction" is defined in Section 1 of Proposed NI 93-101 as "entering into a derivative or making a material amendment to, terminating, assigning, selling or otherwise acquiring or disposing of a derivative…or the novation of a derivative…."

[45] "Derivative," as used in the Proposed Instrument, means "in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon…a 'specified derivative' as defined in Multilateral Instrument 91-101 *Derivatives: Product Determination*." Proposed NI 93-101 at Section 1(6).

[46] *See* Proposed NI 93-101 at Section 40(3)(e).

jurisdiction. The Working Group would appreciate the CSA confirming whether the Working Group's understanding is correct.

Seventh, implementing the changes necessary to comply with requirements of the Proposed Instrument will be time consuming, especially for entities that have never been regulated in a manner similar to a financial institution. Therefore, the CSA should consider providing an extended implementation period for entities that will be subject to the Proposed Instrument that have not previously been regulated as a derivatives dealer or securities dealer or that have not been subject to a similar degree of regulation like banks. The Working Group would recommend a 6-month implementation period for entities previously subject to such regulation and a 12-month implementation period for those that have not.

III. CONCLUSION

The Working Group appreciates this opportunity to provide input on the Proposed Instrument and respectfully requests that the comments set forth herein are considered.

If you have any questions, please contact the undersigned.

Respectfully submitted,
/s/ R. Michael Sweeney, Jr.
R. Michael Sweeney, Jr.
Alexander S. Holtan
Blair Paige Scott

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EXHIBIT I

WHITE PAPER

—

The Need for a *De Minimis* Exception from Registration as a Derivatives Dealer in Canadian Provinces and Proposed Approaches for Implementation

—

By The Canadian Commercial Energy Working Group

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EVERSHEDS SUTHERLAND

THE CANADIAN
COMMERCIAL ENERGY
WORKING GROUP

August 15, 2017

WHITE PAPER

—

The Need for a *De Minimis* Exception from Registration as a Derivatives Dealer in Canadian Provinces and Proposed Approaches for Implementation

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INTRODUCTION

On behalf of The Canadian Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP respectfully offers this White Paper discussing (i) the need for a *de minimis* exception from registration as a derivatives dealer in Canadian provinces ("***De Minimis* Exception**") and (ii) proposed approaches for implementation.

The Working Group is a diverse group of commercial firms that are active in the Canadian energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, owners, and consumers of energy commodities. One of the Working Group's objectives is to provide a voice for energy market participants on regulatory issues related to financial and physical trading of energy commodities and derivatives in Canada.

The Working Group appreciates Canadian regulators' efforts to implement a regulatory framework for derivatives dealer registration that is consistent with Canada's G20 commitment to improve transparency, mitigate systemic risk, and protect against market abuse.[1] To help preserve the integrity of Canada's derivatives markets, however, any derivatives dealer registration regime must appropriately balance these regulatory objectives with the burdens imposed on market participants. Failure to strike an appropriate balance could potentially introduce costs and risks that outweigh the benefits and result in unintended consequences. A *De Minimis* Exception is needed to create a balanced derivatives regulatory framework. To be effective, a *De Minimis* Exception must (i) be set at a workable threshold and (ii) be appropriately implemented.

Part I of this White Paper addresses why a *De Minimis* Exception is needed to achieve a balanced derivatives regulatory framework by explaining why it would: (i) help mitigate unintended consequences while furthering public policy objectives; (ii) provide necessary clarity to market participants; and (iii) establish a proper regulatory scope as regulating all market participants that engage in derivatives dealing activity as derivatives dealers may not be beneficial to Canadian derivatives markets.

Part II of this White Paper focuses on implementation. Specifically, it addresses how to implement a workable threshold for the *De Minimis* Exception by: (i) discussing the need for Canadian regulators to first complete a study on the potential impact on Canadian

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[1] *See* Leaders' Statement: The Pittsburg Summit at 9 (Sept. 24-25, 2009), https://g20.org/wp-content/uploads/2014/12/Pittsburgh_Declaration_0.pdf.

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derivatives markets of derivatives dealer registration requirements both with and without a *De Minimis* Exception; (ii) proposing potential approaches to a *De Minimis* Exception that are consistent with Canadian regulators' overarching policy goals for derivatives reform; and (iii) discussing the calculation of a notional value threshold for commodity derivatives.[2]

I. WHY A *DE MINIMIS* EXCEPTION IS NEEDED TO ACHIEVE A BALANCED DERIVATIVES REGULATORY FRAMEWORK

A. A *De Minimis* Exception Would Mitigate Unintended Consequences and Further Public Policy Objectives.

The Working Group is concerned that without a clear and workable *De Minimis* Exception, most commercial market participants (*i.e.,* non-financial entities whose primary business involves the delivery or consumption of physical commodities) will avoid entering into derivatives transactions that could be deemed dealing activity. In turn, this may result in (i) lower liquidity by forcing available counterparties for end-users out of the market, (ii) further consolidation of risk in systemically important financial institutions, and (iii) an increase in volatility and less competitive pricing. All of these outcomes, whether together or individually, are not in the public interest as they will likely result in Canadian consumers paying more for commodities like gasoline and electricity.

The consequences of the absence of an effective *de minimis* exception have already been observed in the United States. The U.S. Commodity Futures Trading Commission ("**CFTC**") originally set an arbitrary and excessively low *de minimis* exception from registration as a swap dealer for transactions with "special entities."[3] This created a significant issue for so-called "utility special entities" (*e.g.,* government owned or sponsored utilities). Since the *de minimis* level was so low and the consequences of becoming a swap dealer are so significant, the majority of the utility special entities' non-bank counterparties disappeared and liquidity was significantly impaired for utility special entities. To remedy this situation, the CFTC subsequently increased the *de minimis* exception from registration as a swap dealer for transactions with utility special entities.[4]

By adopting a *De Minimis* Exception, Canadian regulators will help mitigate unintended consequences and further public policy objectives, including preserving the integrity of the Canadian derivatives markets and preventing market participants' resources from unnecessarily being diverted from new projects and investment opportunities.

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[2] Discussion of what specifically constitutes "derivatives dealing activity" is outside the scope of this White Paper.

[3] The CFTC defines "special entity" to include (i) federal, state, city, county, or municipal governments, entities, or agencies, (ii) certain employee benefit plans, and (iii) certain non-profit entities. *See* CFTC Regulation 23.401(c), http://www.ecfr.gov/cgi-bin/text-idx?SID=58d66ecadbdc398152f84dd31ae19286&mc=true&node=se17.1.23_1401&rgn=div8.

[4] *See generally* Final Rule, *Exclusion of Utility Operations-Related Swaps with Utility Special Entities from de Minimis Threshold for Swaps with Special Entities,* 79 Fed. Reg. 57,767 (Sept. 26, 2014), http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2014-22966a.pdf.

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B. A *De Minimis* Exception Would Provide the Regulatory Certainty Necessary to Ensure the Efficient Operation of Markets.

Although the derivatives dealer registration regime across the Canadian provinces has not been finalized at this time,[5] it will likely impose significant consequences and burdens on those required to register. Such consequences could likely include the imposition of certain bank-like regulatory requirements, which will result in significant costs.[6]

Given the potential significance of registering as a derivatives dealer, market participants should have a clear understanding as to when registration is required. To provide market participants with additional clarity as to when registration as a derivatives dealer would be required, Canadian regulators should establish a *De Minimis* Exception. A *De Minimis* Exception will allow market participants to (i) engage in a specified amount of activity that ***might constitute*** derivatives dealing activity and (ii) monitor and assess their potential status as a derivatives dealer. In the absence of a *De Minimis* Exception, it is likely that most commercial market participants that currently engage in any degree of activity that could potentially be viewed as dealing activity will cease doing such activity rather than incur any risk of becoming a derivatives dealer. The cessation of such activity by commercial market participants will likely have a material impact on liquidity and may concentrate risk within systemically important financial institutions.

C. A *De Minimis* Exception Would Establish a Proper Regulatory Framework for Regulating Market Participants That Engage in Derivatives Dealing Activity.

In certain derivatives markets, it is clear which market participants are dealers. Markets, such as the interest rate derivatives market and the credit default swap market, typically operate in a hub-and-spoke manner. Under this market structure, dealers are at the center of the market and the vast majority of transactions likely have at least one counterparty that is a bank functioning as a dealer.[7] In markets where there is a clear delineation of dealers and non-dealers, a *De Minimis* Exception may not be necessary.

However, this is not the case in physical commodity derivatives markets. In the Working Group's experience, there are a meaningful number of transactions between non-dealers in Canadian physical commodity derivatives markets. For example, two commercial market participants may have naturally offsetting risk profiles (*e.g.,* a producer and a refiner). Such offsetting risk profiles allow these counterparties to engage in transactions that have

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[5] The Working Group recognizes that Quebec has a derivatives dealer registration regime in place. The Working Group notes that under Quebec's derivatives dealer registration regime, there is an exemption from registration as a derivatives dealer for counterparties transacting with only "accredited counterparties." Thus, Quebec's derivatives dealer registration regime lends credence to the Working Group's assertion in Section I.C of this White Paper that it is not appropriate to regulate all market participants as derivatives dealers. *See, e.g.,* Quebec Derivatives Act at Section 7 (providing the exemption) and Section 3 (defining "accredited counterparty"), http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/I_14_01/I14_01_A.html.

[6] *See* CSA Consultation Paper 91-407 *Derivatives: Registration* (Apr. 18, 2013), http://www.albertasecurities.com/Regulatory%20Instruments/4516880-v1-CSA_Consultation_Paper_Derivatives_-_Registration.pdf.

[7] For example, in interest rate derivative markets, there are likely very few, if any, market participants that engage in dealing activity that are not clearly identifiable as dealers.

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the mutually beneficial purpose of reducing their respective physical commodity price risk exposure.

In certain transactions between commercial market participants, one counterparty might be viewed as engaging in derivatives dealing activity. However, as long as that activity does not reach a meaningful level, registration as a derivatives dealer is not appropriate as there are legitimate commercial reasons for that activity. Those legitimate commercial reasons include the fact that counterparties may have an existing physical commodity trading relationship, so transacting derivatives together is more efficient (*e.g.,* one relationship is easier to manage), and may reduce credit risk as physical and financial exposures can be offset.

In sum, and as noted above, the absence of a properly established *De Minimis* Exception will likely lead to a diminution in commercial market participant to commercial market participant transactions. The reduction in available counterparties will likely harm liquidity and may increase (i) volatility, (ii) the cost of hedging, and (iii) costs for Canadian energy consumers. It may also serve to further concentrate risk in systemically important financial institutions.

II. POTENTIAL APPROACHES TO A *DE MINIMIS* EXCEPTION

A. Canadian Regulators Should Complete a Study Before Proposing a *De Minimis* Exception Threshold.

It is critical for Canadian regulators to ensure that the regulatory framework for derivatives dealer registration is compatible with the unique characteristics of the derivatives market in Canada. Canadian regulators have recognized that Canadian derivatives markets "[comprise] a relatively small share of the global market and a substantial portion of transactions entered into by Canadian market participants involve foreign counterparties."[8] Given these realities, it is critical that the derivatives dealer registration framework does not impose unnecessary regulatory or economic burdens on Canadian market participants or foreign market participants, as this may cause them to exit the Canadian derivatives markets. In addition, it is critical that the derivatives dealer registration framework does not limit Canadian market participants' access to foreign derivatives markets. Ultimately, increased derivatives-related domestic regulatory burdens imposed on commercial market participants and similar regulatory burdens imposed on foreign market participants likely will lead to higher energy prices for Canadian consumers.

It would be difficult to propose an appropriate and meaningful threshold for a *De Minimis* Exception without first conducting a study to better understand trading in Canadian derivatives markets. As such, the Working Group respectfully suggests that Canadian regulators conduct a study on the potential impact on Canadian derivatives markets of derivatives dealer registration requirements both with and without a *De Minimis* Exception prior to proposing any new derivatives dealer registration requirements. That study should utilize the data and insights provided to Canadian regulators from their respective derivatives reporting regimes as well as any other relevant publicly available data. With the benefit of a study, Canadian regulators would be able to make informed decisions about the impact of the potential regulatory requirements.

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[8] CSA Consultation Paper 92-401 *Derivatives Trading Facilities* at 3 (Jan. 29, 2015), http://www.albertasecurities.com/Regulatory%20Instruments/5043114-v1-CSA_Consultation_Paper_92-401_-_Derivatives_Trading_Facilities.pdf.

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B. Alternative Approaches for a *De Minimis* Exception.

There are numerous approaches that regulators could take to implement a *De Minimis* Exception.

1. A Notional-Based Model for a De Minimis Exception.

One option for Canadian regulators to consider adopting is an approach similar to the approach utilized by the CFTC. That approach measures the notional value of an enterprise's dealing activity over the previous 12 months. Under the CFTC's approach, an entity may engage in up to $8 billion gross notional of swap dealing activity over the 12 months immediately preceding the calculation date before registration is required.[9] A market participant would include the dealing activity of affiliates to determine if it has exceeded the *de minimis* threshold.

An approach similar to the CFTC's could be applied at differing levels for each macro category of derivatives (*e.g.,* interest rates, credit, physical commodities). The ultimate determination of an appropriate *de minimis* level would turn on the specific characteristics and composition of each market.

Finally, given the differences in market structure discussed in Section I.C of this White Paper, Canadian regulators could provide a *De Minimis* Exception solely for commodity derivatives markets in order to avoid the potential adverse consequences discussed herein. If a notional-based *De Minimis* Exception is adopted, Canadian regulators should set a higher *de minimis* threshold and adjust it as they deem appropriate after collecting and analyzing market data.

2. A "Relative" Model for a De Minimis Exception.

As another option, Canadian regulators could adopt a "relative approach." Under this option, a market participant would have to register as a derivatives dealer if its dealing activity comprised more than a certain percentage of one of any number of metrics.

Percentage of Market or Revenues. For example, an entity could be required to register as a derivatives dealer only once its dealing activity exceeded a certain percentage of the size of the relevant market. The market data used in that determination should be the market information required to be made publicly available under the various Canadian derivatives reporting rules.[10] In the alternative, regulators could adopt a relative approach where an entity would be obligated to register as a derivatives dealer if more than a certain percentage of its revenue was derived from derivatives dealing activity.[11]

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[9] The CFTC's current $8 billion *de minimis* threshold is set to automatically drop to $3 billion on December 31, 2018, unless the CFTC takes an action to the contrary. The Working Group does not recommend including a trigger that would automatically lower the *de minimis* threshold in any rulemaking implementing a *De Minimis* Exception.

[10] For example, in Ontario, Quebec, and Manitoba, the public dissemination requirements are provided in Section 39 of each province's respective Rule 91-507 *Trade Repositories and Derivatives Data Reporting*.

[11] If regulators elect to use a relative approach, the Working Group suggests that it is done so in a way that does not harm the development of new or small markets (in the case of a market-based

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Number of Dealing Transactions or Dealing Counterparties. Alternatively, Canadian regulators could adopt a *De Minimis* Exception based on the number of dealing transactions an entity enters into or the number of counterparties with which an entity enters into derivatives dealing transactions. Such an approach would be consistent with a number of registration regimes across the world, including the CFTC's commodity trading advisor registration regime, which provides an exemption from registration for entities that have 15 or fewer customers.[12]

Counterparty Characteristics. Finally, Canadian regulators could adopt another form of exemption from derivatives dealer registration based on the character of an entity's counterparties. For example, Canadian regulators could require registration as a derivatives dealer only if an entity engages in a certain level of derivatives dealing activity with counterparties that are not "accredited counterparties" or "qualified parties."[13] As noted in footnote 4 of this White Paper, such an approach would be consistent with Quebec's current derivatives dealer regime.

C. Calculating a Notional Value Threshold for Commodity Derivatives.

The use of a notional value-based threshold for a *De Minimis* Exception raises the issue of how notional value should be calculated for commodity derivatives. The calculation of notional value for commodity derivatives is not as straightforward as it is for other derivatives. The notional value of commodity derivatives is a function of the notional volume of the underlying commodity and not a notional dollar amount, as is used for other products. For example, the notional value of a $100 million interest rate swap is $100 million. However, the notional value of a swap based on 100,000 barrels of crude oil is a function of the price of that crude oil. With that in mind, the Working Group respectfully recommends the following approach for calculating the notional value of a commodity derivative:[14,15]

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relative approach) or unfairly limit activity by smaller market participants (in the case of an entity-based relative approach).

12 *See, e.g.*, CFTC Regulation 4.14(a)(10), http://www.ecfr.gov/cgi-bin/text-idx?SID=57d5e19a7d8ec01beff39af874691fee&mc=true&node=se17.1.4_114&rgn=div8. CFTC Regulation 4.14(a)(10) provides an exemption from registration as a commodity trading advisor if, during the course of the preceding 12 months, an entity has not furnished commodity trading advice to more than 15 persons and it does not hold itself out generally to the public as a commodity trading advisor.

13 *See, e.g.,* Quebec Derivatives Act at Section 7 (providing an exemption from registration as a derivatives dealer for counterparties transacting with only "accredited counterparties"). Under Section 3 of the Quebec Derivatives Act, an "accredited counterparty" is defined to include government entities, financial institutions, persons that meet standards with respect to their knowledge and assets, and hedgers meeting certain conditions.

14 The Working Group's recommended approach for calculating the notional value of a float for float commodity swap is based on CFTC guidance. *See* CFTC Frequently Asked Questions, *Division of Swap Dealer and Intermediary Oversight Responds to FAQs About Swap Entities* at 1 (Oct. 12, 2012), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/swapentities_faq_final.pdf.

15 The Working Group's recommended approach for calculating the notional value of the following is based on industry standard practices: a fixed for float commodity swap; and an option on a commodity. This is consistent with the CFTC's guidance. *See* Joint Final Rule; Joint Interim Final Rule; Interpretations, *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," '"Major Security-Based Swap Participant" and "Eligible Contract Participant,"* 77 Fed. Reg. 30,596 (May 23, 2012) (the "**Entity Definitions Rule**"), http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-10562a.pdf. In the

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- For a floating price commodity swap, the notional value would be the difference between the two floating prices at calculation multiplied by the volume of the contract.

- For a fixed price for floating price commodity swap, the notional value would be the difference between the fixed and floating prices at calculation multiplied by the volume of the contract.

- For an option, the notional value would be the premium multiplied by the volume of the option.

Further, compliance with any *De Minimis* Exception that relies on a notional value threshold should be measured over a period of at least 12 months. Measuring over at least 12 months would avoid short term price swings in commodities markets causing market participants to inadvertently exceed a *De Minimis* Exception.

III. CONCLUSION

The ongoing derivatives reform process in Canada will result in significant changes to the Canadian derivatives markets. The resulting changes will be in terms of how the derivatives markets function and how market participants function within it. As the derivatives dealer registration regime is a key component to the reform process, the regulatory actions prompting change must be based on fully-informed decisions, must be undertaken in a manner that avoids unintended consequences, and must preserve the integrity of the Canadian derivatives markets.

* * *

Should you have any questions about the content contained herein, please contact R. Michael Sweeney, Jr., Alexander S. Holtan, or Blair Paige Scott at Eversheds Sutherland (US) LLP.

Entity Definitions Rule, the CFTC did not provide definitive guidance regarding the calculation of notional amounts for commodity derivatives; however, it did state:

> As is the case for measuring current exposure, the final rules do not prescribe any particular methodology for calculating the notional amount or effective notional amount used in the calculation of potential future exposure, but instead contemplate the use of industry standard practices.

Entity Definitions Rule at 30,670 n.902.

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August 22, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Grace Knakowski
Secretary
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Re: OSC Investor Advisory Panel Response to CSA Notice and Request for Comment – Proposed National Instrument 93-101 Derivatives: Business Conduct

Proposed National Instrument 93-101 aims to govern the business conduct of over-the-counter (OTC) derivatives dealers and advisors, a development that could impact all parties involved in OTC derivatives trading in Canada.

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Although sometimes used for speculative purposes, OTC derivative products such as contracts for difference and foreign exchange forward contracts are also used for hedging purposes and for managing portfolio or business risks. But derivatives can be complex, employ leverage, require margin, lack transparency, and include counterparty risk. As a result, derivatives are generally poorly understood by unsophisticated investors.

As the CSA observed in its consultation paper, the International Organization of Securities Commissions (IOSCO) noted in 2012 that "until recently, OTC derivatives markets have not been subject to the same level of regulation as securities markets. Insufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008."

The Panel supports Instrument 93-101 insofar as it applies similar registration and conduct requirements to derivatives dealers that apply to securities dealers. In our view, that would fill a critical regulatory gap. We also support the CSA's stated goals in the consultation: helping investors, reducing risk, improving transparency and accountability, and promoting responsible business conduct in the OTC derivative markets.

To that end, the Panel makes the following recommendations:

Suitability – Advisors must ensure that any recommendation involving derivatives is based not just on the suitability of a product, but also fits within the context of a client's portfolio. What is the purpose of including it (e.g., to reduce volatility)? Is it appropriate given the client's overall risk profile? And how does it support the client's desired outcome (e.g., retirement security)?

Enhanced compliance – Sales of OTC derivatives should trigger enhanced branch manager and/or compliance scrutiny.

Proficiency – The Panel recommends that existing training and licensing available to advisors related to derivatives be reviewed and enhanced to ensure advisors are properly trained and have sufficient understanding to use these products appropriately. Firms must also have robust Know Your Product processes in place.

Simple transparency – Investors need enhanced plain language risk disclosure including simple illustrations of the return profiles across a wide range of market environments. This should clearly demonstrate the risks and potential returns.

Best interests - The Panel again urges regulators to enact a best interest advice standard without delay. Such a standard would provide the necessary environment in which to properly employ derivatives to improve outcomes for investors and ensure that anyone giving personalized investment advice does so with the proficiency and integrity required of a professional, not a salesperson.

Waiver - The Panel is concerned that an investor's ability to waive the applicability of the proposed instrument may result in abuse.

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Finally, the Panel notes that most direct retail investor exposure to derivatives will continue to be through exchange-traded products, such as futures and options. Retail investors will also have exposure to derivatives through investment products such as exchange-traded funds or mutual funds that use derivative contracts to employ leverage and are designed to produce different outcomes than simple long-only fixed income or equity products.

These derivatives continue to be regulated under existing securities regulations and do not fall within the scope of the proposed instrument. Given that derivatives are complex and often poorly understood, their use in any form should require the highest standard of care on the part of those who recommend them.

Yours truly,

Letty Dewar
Chair, Investor Advisory Panel

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Bruce Power

VIA EMAIL

August 25, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Care of:

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and

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Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct and Proposed Companion Policy*

Dear Members of the Canadian Securities Administrators:

Bruce Power L.P. hereby submits comments to the Canadian Securities Administrators (the "**CSA**") with respect to CSA Notice and Request for Comment on National Instrument 93-101 Derivatives: *Business Conduct and Proposed Companion Policy* dated April 4, 2017 (the "**Instrument**"). We thank you for providing interested parties with the opportunity to submit comments and look forward to further participation in this important process.

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Bruce Power operates the world's largest nuclear site and is the source of roughly 30 per cent of Ontario's electricity. The company's site in Tiverton, Ontario is home to eight CANDU reactors, each one capable of generating enough low-cost, reliable, safe and clean electricity to meet the annual needs of a city the size of Ottawa. Formed in 2001, Bruce Power is an all-Canadian partnership among TransCanada Corporation, BPC Generation Infrastructure Trust (an investment entity of OMERS Administration Corporation), two trusts constituted by the Power Workers Union, a trust constituted by the Society of Energy Professionals and a trust through which a majority of Bruce Power's employees have invested in Bruce Power. Bruce Power is involved in the electricity wholesale market in Ontario and also sells electricity at the retail level in Ontario.

We have the following comments on the proposed Instrument. We would note that it has been more challenging to properly assess the impact of the Instrument without the benefit of having the opportunity to review the proposed National Instrument 93-102 *Derivatives Registration* (the "**Proposed Registration Instrument**"). The two documents appear to be closely connected. We look forward to the issuance of the Proposed Registration Instrument so that we can better understand the overall impact of both the dealer registration and business conduct requirements.

I. Derivatives Dealer & *De Minimis* Threshold

The Instrument applies to a derivatives dealer unless the exemptions for certain end-users as set out in Section 39 apply. A "derivatives dealer" is defined in Section 1 of the Instrument as, among other things, a company that engages in the business of trading in derivatives as principal or agent. The proposed Companion Policy to the Instrument (the "**Policy**") provides guidance on what type of activities should be considered in determining whether or not a company is in the business of trading in derivatives. These triggers enumerated in the Policy are quite broad and include engaging in frequent or regular transactions for profit and contacting others to solicit derivatives transactions. It would appear that most use of derivatives by a company, except on an infrequent basis, might result in that company being viewed as a derivatives dealer and, consequently, subject to the business conduct requirements of the Instrument.

As drafted, the end-user exemption in Section 39 provides a fairly narrow exemption from the requirements of the Instrument if, among other things, a company is an infrequent user of derivatives. Section 39(c) would exclude the application of the end-user exemption if a company regularly quotes prices at which they would be willing to transact in a derivative. The Policy suggests that the exemption might still apply if a company uses derivatives on a more frequent basis as long as derivatives are used in the ordinary course of their business to

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hedge risk and the user receives, rather than offers, quotes at which they are willing to buy.

Although the Instrument, along with the Policy, provide some guidance on (i) what the CSA considers to be trading in derivatives and (ii) when the end-user exemption may apply, there is still some uncertainty. We believe that the introduction of a more objective *de minimis* threshold would provide much-needed clarity to derivatives users. Trades below the *de minimis* threshold would provide an exemption to the application of the requirements under the Instrument. By introducing a *de minimis* threshold, a company that trades either below or in excess of a specific threshold, whatever that threshold may ultimately be and however it may be measured, would know whether or not it would be viewed as a derivatives dealer and thus subject to the requirements of the Instrument.

Although we understand the rationale in the Instrument for providing less-sophisticated users of derivatives/consumers with broader protections, the rationale is less compelling for trades with an "eligible derivatives party" ("**EDP**").

Bruce Power strongly encourages the CSA to implement a *de minimis* exemption in a manner consistent with the approach adopted by the Commodity Futures Trading Commission ("**CFTC**"), with comparable levels. Since lower volumes of derivatives trading would arguably not give rise to a significant level of market risk, it seems reasonable that the registration requirements and the business conduct requirements should only be required for participants whose trading activity in the Canadian derivatives market is substantial. There should be a reasonable and proportionate balance between any regulatory/administrative burden and the risk that the regulatory regime purports to address.

In the absence of an objective *de minimis* threshold, it may well be that companies would take a conservative approach and assume that their use of derivatives could be viewed as engaging in the business of trading derivatives. The costs to a company of ensuring compliance with the requirements of the Instrument, to say nothing of the costs of registration as a derivatives dealer under the Proposed Registration Instrument, might outweigh the perceived benefits of engaging in these trades and deter some companies from participating in the derivatives market. This would be particularly true for many commercial, non-financial entities whose primary business involves the delivery or consumption of physical commodities or for non-financial entities that use derivatives to trade as a principal for their own account and engage in derivative trades with knowledgeable counterparties. A reduction in the number of market participants who engage in derivatives trades could lower market liquidity (especially in the commodity markets), increase volatility, impact pricing and consolidate risk with financial institutions.

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II. Eligible Derivatives Party

The Instrument defines an EDP as, among other things, a company that has net assets of at least $25 million. We would suggest that the threshold be more in line with the $10 million in total assets set out in the definition of "eligible contract participant" in the U.S. *Commodity Exchange Act*. Alternatively, the CSA could allow market participants to affirmatively represent that they are qualified to evaluate the risks associated with derivatives transactions and consent to being treated as an EDP if they would not otherwise qualify as such. If the threshold for qualification for an EDP is set too high, some knowledgeable market participants who regularly use derivatives in the course of their business and who do not meet this threshold may encounter difficulties in continuing to transact using derivatives. Some counterparties may be reluctant to deal with a non-EDP, given the added costs that are associated with derivative transactions with a company that is not an EDP.

III. End-User Exemption

We would suggest that the end-user exemption be available to entities even if they regularly quote prices. The CSA states in the Policy that it "would not be reasonable for a person or company who regularly quotes prices on derivatives to other derivatives parties to claim that they are an end-user hedging business activities." In Bruce Power's view, it is possible in the commodity derivatives market to state a price at which a company would be willing to purchase and a price at which the company would be willing to sell. Prudent hedge management may result in an end-user taking an opposing position to its natural hedging position. The end-user exemption should be available to entities even if they regularly provide quotes on one or both sides of the market.

IV. Record Keeping

Bruce Power is concerned that the record-keeping requirements, as proposed, are too broad and will be overly burdensome for certain market participants. If no *de minimis* threshold of dealer activity is implemented in the Instrument and/or the Proposed Registration Instrument, the proposed record-keeping requirements may capture relatively small businesses that do not have the capability or resources to meet the requirements as drafted without undue burden. Bruce Power suggests that the recordkeeping requirement be limited to the obligation to retain records of communications when entering into *binding* obligations, that is, communications with a counterparty or broker that evidence binding acceptance, offer or instructions.

The Instrument requires that records be kept for a period of seven years following the termination/expiry date of the swap. This seven-year retention

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period beyond the expiry of the transaction seems quite long in our view and exceeds the CFTC requirements. We would appreciate some clarification from the CSA on why this period of time was deemed to be appropriate and whether a shorter period may be more appropriate in the context of certain records (e.g., phone calls, to the extent that they are required to be recorded).

V. Implementation Period

The Instrument sets out a number of obligations and requirements that a derivatives firm will need to comply with. We would request that the CSA allow a sufficient implementation period so that companies that have not previously been regulated in a similar manner proposed by the CSA in the Instrument have adequate time to resource, design, and implement new processes to address these requirements. Bruce Power suggests a minimum of a one-year implementation period.

Bruce Power thanks the CSA for this opportunity to provide comments on the Instrument.

Yours truly,

William Schnurr
Assistant General Counsel

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Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

August 29, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sirs/Mesdames,

Re: Pension Investment Association of Canada ("PIAC") Comments on CSA Proposed National Instrument 93-101 – Derivatives: Business Conduct

INCLUDES COMMENT LETTERS

The Pension Investment Association of Canada (PIAC) would like to thank the CSA for considering our comments on Proposed National Instrument 93-101 – Derivatives: Business Conduct (the "Proposed Regulations") and accompanying Companion Policy.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over $1.8 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC's positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

PIAC is supportive of the CSA's efforts to introduce business conduct regulations on derivatives dealers and derivatives advisers. PIAC would like to comment on the following aspects of the Proposed Regulations:

- PIAC supports the fair dealing requirements within section 8, and specifically, PIAC believes that it is important that Canada's securities regulators have the regulatory tools necessary in order to bring enforcement against deceptive and manipulative trading practices or fraudulent activities by dealers.

- PIAC supports the requirements to disclose conflicts of interest (Section 9(3)) and would stress the importance that meaningful disclosure be specific and be provided shortly before a transaction takes place.

- PIAC is concerned with the inclusion of "Directly or indirectly carrying on the activity with repetition, regularity or continuity" and "Transacting with the intention of being compensated" as factors to be considered in determining whether a person or company meets the definition of "derivatives dealer" or "derivatives adviser". These factors, as drafted, are overly broad and may inadvertently capture pension plans or their sponsors.

- PIAC is concerned that the investment-related services provided by pension plan sponsors to their sponsored plans, such as hiring third party investment managers, could be considered to be derivatives advice, and requests a specific exemption or guidance in the Companion Policy to address this outcome.

- PIAC is concerned with the proposal that would subject to derivatives advisers providing managed account services to eligible derivatives parties to all of the proposed business conduct requirements. Large and sophisticated pension plans do not need, or should be permitted to waive, business conduct requirements designed to protect retail investors.

- PIAC supports the proposed exemption for foreign derivatives advisers, given the importance for pension plans to access global expertise, however the proposed exemption is too narrow given that many jurisdictions do not subject derivatives advisers to a registration requirement.

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- PIAC supports the proposed requirements for derivatives dealers and advisers to segregate client assets, however dealers and advisers must have some flexibility to use assets to appropriately collateralize or margin derivatives transactions.

Detailed discussion of each comment follows below.

1) Fair Dealing

PIAC supports the fair dealing requirements within Section 8 of the Proposed Regulations and the concept that a derivatives firm or individual acting on behalf of the firm must deal fairly, honestly, and in good faith with a derivatives party. We note that, because PIAC members act as administrators / trustees of or otherwise act on behalf of various pension plans / funds, it is of great concern to PIAC members that derivatives dealers deal fairly and in good faith, as improper activities on the part of dealer counterparties could have a direct impact on the retirement benefits of our members. Specifically, PIAC believes that it is important that Canada's securities regulators have the regulatory tools necessary to sanction dealers that engage in deceptive and manipulative trading practices or fraudulent activities. We have seen examples of these types of activities in foreign markets (FX Fixing or LIBOR market manipulation). We believe that the CSA should adopt fair dealing requirements that are similar to those in the United States, where derivatives business conduct rules in § 23.410 General Regulations under the Commodity Exchange Act of the Code of Federal Regulations, Title 17, Chapter I, state as follows:

> § 23.410 Prohibition on fraud, manipulation, and other abusive practices.
> (a) It shall be unlawful for a swap dealer or major swap participant -
> (1) To employ any device, scheme, or artifice to defraud any Special Entity or prospective customer who is a Special Entity;
> (2) To engage in any transaction, practice, or course of business that operates as a fraud or deceit on any Special Entity or prospective customer who is a Special Entity; or
> (3) To engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.

PIAC notes that similar prohibitions against fraud, deceptive and manipulative trading practices in respect of OTC derivatives transactions appear to be included in Section 126.1 of the Ontario Securities Act, R.S.O., 1990, c. S.5, for example. It is important that similar prohibitions be included in the securities laws of each province and territory of Canada. PIAC believes that the "fair dealing" provisions in the Proposed Regulations should capture circumstances involving fraud, market manipulation or other abusive practices, however the CSA should also consider the specific inclusion of these practices within the Proposed Regulations (to the extent not already included in provincial securities legislation).

2) Disclosure of Conflicts of Interest

PIAC supports the requirements to disclose conflicts of interest (Section 9(3)) and would stress the importance that disclosure be specific and be provided shortly before a transaction takes place, and should not be met by a catch-all regulatory disclosure sent to

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all clients well in advance of any affected transaction. We believe that there is little value in catch-all disclosure of conflicts of interest that are sent to clients well in advance of a trade (e.g., on an annual basis).

In the event that the revised Proposed Regulations incorporate the ability for conflicts of interest to be disclosed on an omnibus basis, PIAC recommends that these disclosures be separated into two categories: (i) general conflicts of interest disclosures applicable to all counterparties and (ii) disclosures specific to a counterparty or a specific contemplated transaction. PIAC views disclosures of general conflicts of interest to be those which affect all counterparties and transaction types, and which could potentially be addressed in a written general (potentially annual) disclosure of conflicts of interest. On the other hand, PIAC places more importance on specific disclosures of conflict of interest that are material and specific to a counterparty or a particular transaction. We believe that such disclosure should be provided shortly before a transaction takes place, and that it should be specific, clear and meaningful. For instance, a dealer could disclose the conflict to a trader of a counterparty over a taped line prior to trading, or send a written notice to the individual with the counterparty that is expected to enter into the transaction shortly before a transaction. We would also note that in some circumstances, it might be appropriate for a dealer to disclose a conflict after a transaction has taken place, for example, in the case of an equity total return swap where subsequent to entering into a transaction, a dealer becomes an M&A adviser in respect of the equity underlier (where the proposed M&A activity has been publicly announced) and also seeks to engage in further trades.

3) Derivatives Dealer and Adviser - carrying on the activity with repetition, regularity or continuity or transacting with the intention of being compensated

PIAC is concerned with the inclusion within the Companion Policy of “Directly or indirectly carrying on the activity with repetition, regularity or continuity” and “Transacting with the intention of being compensated” as factors to be considered in determining whether a person or company meets the definition of “derivatives dealer” or “derivatives adviser”.

Pension plans, due to their size and mandate, might engage in various types of OTC derivatives transactions with repetition, regularity or continuity and may earn various forms of compensation, including cost recovery, for doing so, however, such plans and their sponsors do not act as a dealer (or adviser) in any traditional sense. For example, pension plans may hedge foreign currencies, which usually involves rolling multiple three month FX forward transactions with repetition and continuity. Moreover, pension plans might seek various OTC derivatives strategies in order to obtain broad market exposures (such as through the use of equity swaps).

Respectfully, the use of OTC derivatives by pension plans should not be indicative of the activities of a dealer, regardless of trading frequency or potential for compensation. Instead, we believe that the other factors articulated by the CSA in the Companion Policy to the Proposed Regulations, including acting as market maker, intermediating transactions, solicitation of trades and providing derivatives clearing services, are the hallmarks of what are generally regarded as dealer or adviser activities. We are concerned that the inclusion of the factors "Directly or indirectly carrying on derivatives trading activity with repetition,

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regularity or continuity" and “Transacting with the intention of being compensated” has the potential to capture pension plans and their sponsors. In our view, frequent derivatives trading activity, whether or not any compensation (as broadly described in the Companion Policy) is received, in the absence of the other business purpose factors, should not constitute dealing or advising activities.

We acknowledge that Section 39 of the Proposed Regulations [Exemption for certain derivatives end-users] may be useful for a pension plan that engages in regular derivatives trading activity, but the exemption may be of limited utility for a pension plan that may, in the ordinary course of business, quote prices at which it would be willing to transact or for a pension sponsor that provide investment-related services to their sponsored plans. Large pension plans with internal trading functions may be excluded from the end-user exemption simply by quoting prices to dealer counterparties, even though those pension plans do not solicit trades, offer to make a market in a derivative or otherwise act as a derivatives dealer or adviser.

4) Derivatives Adviser – Pension Plan Sponsors and Affiliates

PIAC is concerned that the definition of “derivatives adviser” in the Proposed Regulations could be interpreted broadly to capture pension plan sponsors and their affiliates that are providing investment-related services to their sponsored plans. For instance, this could arise where plan sponsors and their affiliates are engaged in hiring, and providing investment guidelines to, third party investment managers. In this context, plan sponsors and their affiliates may be making asset allocation decisions and exercising discretion in selecting specific derivatives trading strategies, such as tactical asset allocation overlay and hedging programs. PIAC is concerned that these types of activities could trip the “business trigger” underlying the definition of “derivatives adviser” if the discretion exercised and the investment guidelines provided are broadly considered to be derivatives advice.

It is submitted that the factors listed in the Companion Policy for determining whether a party is in the business of advising in respect of derivatives are primarily focused on dealer activities and, as a result, there is ambiguity or a lack of clarity about when a person will be considered to be engaged in the business of advising others as to transacting in derivatives. Many of the factors in the Companion Policy, such as quoting prices and transacting with the intent of being compensated, are not relevant to advisers. Moreover, the one factor that references “engaging in activities similar to a derivatives adviser” is overly broad and could be interpreted to capture pension plan sponsors and their affiliates involved in pension plan investing, particularly if they are making decisions regarding asset allocation and providing investment guidelines to third party managers.

To address the above concerns, PIAC respectfully requests that the CSA provide a specific exemption or specific guidance in the Companion Policy that Canadian pension plan sponsors and their affiliates who are providing investment-related pension services, such as those described above, are exempt from the Proposed Regulations or otherwise are not engaging in the business of advising others as to transacting in derivatives for purposes of the Proposed Regulations.

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5) Managed Account of an Eligible Derivatives Party (EDP)

Although PIAC supports the fair dealing requirements and the requirements to disclose conflicts of interest that will apply to derivatives dealers and derivatives advisers under the Proposed Regulations, PIAC is concerned about the approach adopted in Section 7(3) of the Proposed Regulations which would subject derivatives advisers providing managed account services to Canadian pension plans to all of the proposed business conduct requirements of the Proposed Regulations, despite the fact that Canadian pension plans are EDPs under the Proposed Regulations. PIAC is concerned that Canadian pension plans will have greater difficulty securing the services of global investment management firms in respect of derivatives-related activities when those global firms will be subjected to a broad set of business conduct requirements that are more appropriately applicable to a retail investment advisory business.

PIAC submits that EDPs such as Canadian pension plans are sophisticated investors that should not be treated like non-EDPs solely because they have chosen to invest and obtain advisory services through a managed account arrangement. If the CSA considers it necessary to apply a different standard to firms providing managed account services to EDPs, then PIAC respectfully requests that the CSA at least provide an opportunity for EDPs such as Canadian pension plans to waive the protections under the Proposed Regulations that would not apply to EDPs outside of the managed account context.

6) Foreign Derivatives Adviser Exemption – Section 44

PIAC supports the exemption in Section 44 of the Proposed Regulations for foreign derivatives advisers that meet certain criteria or conditions. However, PIAC submits that the exemption is overly narrow to the extent that it requires the foreign adviser to be registered in the foreign jurisdiction in which it maintains its head office or principal place of business (Section 44(3)(a)). PIAC submits that the exemption should be amended to include foreign advisers that are exempt from registration or are not required to be authorized as an adviser in their home jurisdiction. So long as foreign derivatives advisers are conducting business in a jurisdiction with a regulatory framework that meets international standards, it is submitted that the foreign derivatives advisers should be permitted to take advantage of the exemption in Section 44 even if they are not subject to a registration requirement in that foreign jurisdiction.

It is also noted that the exemption for foreign derivatives advisers in Section 44 is not available where the adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in "the jurisdiction". It is unclear why this condition is necessary and it is submitted that this may significantly restrict the ability of Canadian pension plans to secure the services of foreign derivatives advisers that are subscribers to derivatives trading marketplaces that are so designated or recognized.

7) Derivatives Party Assets (Part 4, Division 2)

While PIAC supports the requirement in the Proposed Regulations that derivatives dealers and advisers segregate client assets from the dealer's or adviser’s own assets, PIAC is

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concerned that the requirements in Division 2 of Part 4 regarding the manner in which a derivatives firm must hold derivative party assets may give rise to unintended consequences for derivatives dealers and derivatives advisers serving Canadian pension plans. It is submitted that derivatives firms providing services to Canadian pension plans must have the flexibility to use the assets of Canadian pension plans to appropriately collateralize or margin derivatives transactions. PIAC requests that the CSA give due consideration to the requirements of this part of the Proposed Regulations so that derivatives firms within and outside Canada are not restricted in the manner in which they conduct their business in providing services to Canadian pension plans.

Seven PIAC Areas of Focus

We would like to thank the CSA for considering the comments from PIAC on the Proposed Regulations and accompanying Companion Policy.

In summary, PIAC believes that: (1) it is important to have the regulatory tools necessary to sanction deceptive and manipulative trading practices, and fraudulent activities; (2) meaningful disclosures of conflicts of interest specific to a derivatives transaction should be required; (3) the business triggers factors of trading with regulatory or with the intention of compensation should be narrowed for determining whether a party is a derivatives dealer or adviser, (4) investment-related services provided by pension plan sponsors should not be derivatives adviser activity, (5) derivatives advisers should not be required to comply with the full set of business conduct requirements when providing managed account services to EDPs; (6) the conditions for reliance on the exemption for foreign derivatives advisers should be modified to include unregistered firms and (7) there must be flexibility in the requirements for treatment of client assets.

We trust our response has been helpful. Thank you for your attention and please do not hesitate to contact us if you have any questions or concerns.

Yours sincerely,

Kevin Fahey
Chair

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WU BUSINESS SOLUTIONS

August 30, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Anne-Marie Beaudoin
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Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
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Toronto, Ontario M5H 3S8

Dear Sirs / Mesdames:

Re: CSA Notice and Request for Comment ("CSA Notice") on Proposed National Instrument 93-101 Derivatives: Business Conduct ("93-101") and Proposed Companion Policy 93-101 CP Derivatives: Business Conduct ("93-101 CP")

Custom House ULC operating as Western Union Business Solutions ("Western Union") appreciates the opportunity to comment on 93-101 and 93-101 CP. Capitalized terms used in this letter and not defined herein will have the same meaning as in the CSA Notice. Western Union is submitting comments now as requested in the CSA Notice and after seeing the registration rule once it is released, we may have further comments on

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93-101 and 93-101CP after reviewing the registration rule alongside these draft conduct rules.

1. Uniform approach across Canada

Western Union is extremely supportive of the intention to "create a uniform approach to derivatives market conduct regulation in Canada". Adopting a regime that is applied and interpreted consistently across the country for financial institutions, provincial credit unions and other market participants is very welcomed and we believe it will assist in ensuring an even competitive playing field for all market participants in the FX asset class in the marketplace.

2. Broadening the definition of eligible derivatives party to include hedging

Western Union requests that the regulators consider broadening the definition of eligible derivatives party to include a hedging exemption similar to the "qualified party" section (p) in Saskatchewan's General Order 91-908 Over-the-Counter-Derivatives.[1] As highlighted in the CSA Notice, derivatives are different than securities and the risks associated with such products are also different. When entities, including small businesses, enter into FX hedging transactions, they are doing so based on the knowledge of their business and their business' needs and are using such FX derivatives as risk management tools to hedge their currency risk exposure. Western Union sells FX derivatives products to its customers who enter into such transactions for risk management purposes to hedge their FX exposure and not for investment or speculative purposes. Based on these factors, we think that adding a hedging qualification to the definition of eligible derivatives party is warranted.

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[1] "qualified party" means …

(p) a person who or company that is an accredited investor and buys, sells, trades, produces, markets, brokers or otherwise uses a commodity in their business and that enters into an OTC derivative, provided that a material component of the underlying interest of the OTC derivative is:

(i) a commodity that the person or company buys, sells, trades, produces, markets, brokers, or otherwise uses in its business;

(ii) a related commodity, security or variable;

(iii) a commodity, security or variable that directly or indirectly affects the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in its business;

(iv) a commodity, security or variable for which there is a high degree of correlation between the movement in its value and the movement in the value of the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in its business; or

(v) another OTC derivative, where a material component of the underlying interest of that OTC derivative is a commodity, security or variable referred to in sub-clauses (i) to (iv) to above;

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3. Senior Derivatives Manager Position

It was unclear in reading 93-101 and 93-101CP whether or not the intention is that the Senior Derivatives Manager be held personally liable when carrying out their duties in this role. We note that 93-101 requires that the Senior Derivatives Manager must **certify** annually to the board of directors that the derivatives business unit is in material compliance or specify all instances of material noncompliance. By comparison, a Chief Compliance Officer of a securities registrant is required to "submit [NOT CERTIFY] an annual report to the firm's board of directors, or individuals acting in a similar capacity for the firm, for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation."

Western Union would ask that the regulators consider why there would be a different standard between derivatives and securities for similar positions and consider whether the intention is for the Senior Derivatives Manager position to attract personal liability. If the intention is for the Senior Derivatives Manager position to attract personal liability, Western Union would ask the regulators to consider that there not be personal liability for this position for the FX asset class, as we feel this would be too strict a standard, and would make it challenging and costly to fill this role, especially because we are unaware that such a standard has been demonstrated to be warranted in the marketplace for the FX asset class.

4. Implementation Time

Western Union asks that the regulators consider a lengthy time period to implement the changes needed to become compliant with 93-101 and would ask that the minimum implementation period be a period of one year. A lengthy implementation period is needed to ensure compliance with the new rules, including time to amend existing policies and procedures, train staff on new policies and procedures, amend existing documentation and collect any new executed customer documentation as applicable and develop new reporting requirements, as applicable.

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Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at shannon.seitz@westernunion.com, on this or any other issue in future.

Shannon Seitz
Counsel, Western Union Business Solutions

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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

August 30, 2017

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("NI 93-101") and Related Proposed Companion Policy (the "Companion Policy", and together with NI 93-101, the "Proposed Rules")

INTRODUCTION

The Canadian Market Infrastructure Committee ("**CMIC**") is pleased to provide this comment letter on the Proposed Rules.

CMIC was established in 2010, in response to a request from Canadian public authorities,[1] to represent the consolidated views of certain Canadian market participants on proposed regulatory and legislative changes in relation to over-the-counter ("**OTC**") derivatives. The members of CMIC who are responsible for this letter are: Alberta Investment Management Corporation, Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Citigroup Global Markets Inc., Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan Trust Fund, HSBC Bank Canada, Invesco Canada Ltd., JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation,

[1] "Canadian public authorities" means representatives from Bank of Canada, Canadian Securities Administrators, Department of Finance and Office of the Superintendent of Financial Institutions ("**OSFI**").

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Morgan Stanley, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Public Sector Pension Investment Board, Royal Bank of Canada, Sun Life Financial, The Bank of Nova Scotia and The Toronto-Dominion Bank.

CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian OTC derivatives market. The membership of CMIC has been intentionally designed to present the views of both the 'buy' side and the 'sell' side of the Canadian OTC derivatives market, including, but not limited to, both domestic and foreign owned banks operating in Canada as well as major Canadian institutional market participants (including a number of major pension funds) in the Canadian derivatives market. This letter reflects the consensus of views within CMIC's membership about the proper Canadian regulatory and legislative regime applicable to the OTC derivatives market.

In providing our comments on the Proposed Rules, CMIC notes the difficulty in fully assessing the Proposed Rules in the absence of reviewing the proposed derivatives dealer registration rules (the "**Registration Rules**"). Accordingly, CMIC reserves the right to provide further comments if the Registration Rules give rise to any further issues relating to the Proposed Rules. In addition, given the magnitude of the combined effect of the Proposed Rules and the Registration Rules, CMIC submits that the regulators and market participants would benefit from an additional joint comment period after the regulators have fully reviewed and considered all comments received on both the Proposed Rules and the Registration Rules.

EXECUTIVE SUMMARY

Our comments in this letter generally fall within four principal themes:

1. Duplication of Existing Rules: The Proposed Rules require a robust public policy justification and comprehensive regulatory impact assessment. Many provisions in the Proposed Rules duplicate existing laws and regulations. Accordingly, we recommend that they be deleted as they are unnecessary or, in the alternative, that substituted compliance be granted.

2. OTC Derivatives Markets vs Securities Markets: There are fundamental differences between the securities markets and the OTC derivatives markets. We recommend that certain rules be amended or deleted in order to reflect those fundamental differences.

3. Harmonization: The Canadian OTC derivatives markets is a part of a global market that relies heavily on global participants. Accordingly, we recommend that the Proposed Rules be harmonized with global rules, particularly with the Commodity Futures Trading Commission's ("**CFTC**") rules[2] under Dodd-Frank.[3]

4. Timing of Implementation: Given the proposed review and re-assessment of the CFTC rules and the fact that the Securities and Exchange Commission's business conduct rules are not in force, we recommend delaying the implementation date of the Proposed Rules to better ensure harmonization.

Here is a brief summary of our recommendations:

- We recommend that the regulators exempt the inter-dealer market from the Proposed Rules.

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[2] The CFTC's business conduct rules are principally located in the *Code of Federal Regulations*, Title 17, Chapter I, Part 23 ("**17 CFR Part 23**"), available at: https://www.ecfr.gov/cgi-bin/text-idx?SID=dbb5c5a633932a41e806929529662e54&mc=true&node=pt17.1.23&rgn=div5.

[3] *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub.L. 111-203, H.R. 4173 ("**Dodd-Frank**"), available at: http://www.cftc.gov/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf.

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- Due to the maturity and transparency of the foreign exchange market, we recommend an exemption whenever a derivatives firm adheres to a global foreign exchange code of conduct and transacts in foreign exchange transactions.

- We recommend that the definition of "eligible derivatives party" be revised to:

  - lower the threshold in paragraph (m) for a non-individual to $10 million;
  - remove the knowledge and experience requirements under paragraphs (m) and (n);
  - add a hedger category; and
  - add "permitted client" as defined under NI 31-103[4] as an additional category.

  As a related point to the definition of "eligible derivatives party", we recommend that Section 7(2) of the Proposed Rules be deleted in order to remove the waiver requirement for individuals and that Section 7(3) of the Proposed Rules be deleted in order to apply the two-tiered approach to an adviser of a managed account for an eligible derivatives party.

- We recommend that the business trigger commentary regarding the definition of "derivatives dealer" be amended to limit the activity to market making activity.

- The use and investment of derivatives party assets should be expressly limited to collateral and subject to existing margin rules, or other applicable rules, and otherwise be subject to bilateral contractual arrangements with respect to re-hypothecation.[5]

- The proposed senior derivatives manager regime is not appropriate in Canada as it relates to federally-regulated financial institutions ("**FRFIs**") and therefore should not be applicable as it results in oversight fragmentation.

- We recommend substituted compliance for almost all the other provisions for both domestic financial institutions regulated by OSFI and for foreign derivatives dealers as outlined in detail in the attached Schedule A and Schedule B.

This letter will begin by setting out several general comments that elaborate on the four principal themes mentioned above. We will then respond to specific questions raised by the regulators in the Proposed Rules. This is followed by our additional comments relating to provisions that were not specifically raised by the regulators. Finally, in Schedule A and B of this letter, we provide the results of our extensive analysis relating to existing rules.

GENERAL COMMENTS

Duplication of Existing Rules: CMIC is supportive of appropriate business conduct rules in the OTC derivatives markets. However, in CMIC's view, there are many provisions of the Proposed Rules that are duplicative of, or already sufficiently addressed in, existing Canadian law, particularly for FRFIs. In this letter, we will highlight and discuss these provisions and present arguments as to why they are duplicative and should be removed from the Proposed Rules because they are unnecessary. CMIC submits that since the Proposed Rules change the cost of compliance for businesses, the Proposed Rules fall within the scope of the Ontario Regulatory Policy[6] and equivalent policies in other

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[4] National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy3/PDF/31-103__NI___July_15__2016/.

[5] As used in this letter, the term "**re-hypothecation**" includes re-use and re-pledging.

[6] Ontario Regulatory Registry, *Ontario Regulatory Policy* (the "**Ontario Regulatory Policy**"), available at http://www.ontariocanada.com/registry/downloads/Ontario%20Regulatory%20Policy.pdf. We note that each other Province is bound by similar rules and/or principles.

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provinces[7]. The Ontario Regulatory Policy creates more open and responsive ways for government to work with business to deliver results, while protecting the public interest. One of the principles under the Regulatory Policy is that duplication of regulation should be minimized, where appropriate. As noted above, it is CMIC's view that the Proposed Rules significantly overlap with existing rules that are operating effectively and, in many cases, in a different manner. As a result, we do not believe the Proposed Rules are necessary given the effectiveness of existing regulations. That said, although the protection afforded to derivatives counterparties under the existing rules on a principled basis is the same as the Proposed Rules, the Proposed Rules are not identical to existing rules, which means that market participants will need to spend considerable time and resources understanding the nuances between the Proposed Rules and the existing rules. Such duplication results in inefficiency because market participants need to keep track of any amendments and case law with respect to two or more sets of rules and incur associated implementation, outreach, compliance and monitoring costs. Thus, if the Proposed Rules are implemented, notwithstanding our concerns, CMIC urges that they be harmonized to the fullest extent possible with applicable existing rules and that the CSA periodically revise the Proposed Rules to accommodate developments in the existing rules to maintain harmonization.

Another principle of the Ontario Regulatory Policy is that proposed regulations must respond to a clearly identified need for regulation. While other international jurisdictions have imposed business conduct rules for OTC derivatives, it is CMIC's view that a robust public policy justification has not yet been presented that these separate rules are necessary in Canada. A recent IOSCO report[8] indicates several factors in wholesale markets that may give rise to potential risks of market misconduct, including decentralized market structures and the opaque nature of markets. These factors have been addressed in the OTC derivatives market through recent reforms such as trade reporting, public dissemination, electronic trading platforms, mandatory clearing and uncleared margin. Other factors identified by IOSCO such as the size and organizational complexity of large market participants and the corresponding need for appropriate governance are already very effectively addressed in the Canadian OTC derivatives market through existing prudential and market conduct rules. Accordingly, we do not believe that the factors identified by IOSCO are relevant in the Canadian OTC derivatives market, nor have such factors been demonstrated to give rise to misconduct in this market. In this regard, to our knowledge in the Canadian OTC derivatives market there have been no appreciable or material examples of market misconduct by banks or other derivatives dealers in Canada. In addition, CMIC notes that market conduct was not listed as one of Canada's G-20 commitments.[9] To our knowledge, Canadian regulators have not presented clear

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[7] British Columbia, Ministry of Small Business and Red Tape Reduction, *Regulatory Reform Policy*, available at http://www2.gov.bc.ca/assets/gov/government/about-the-bc-government/regulatory-reform/pdfs/final_regulatory_reform_policy_-_aug_2016.pdf; Alberta, Regulatory Review Secretariat, *Regulatory Excellence*, available at https://open.alberta.ca/dataset/79a65442-7aca-4287-b8c5-b5c324f590bd/resource/e919b4bb-acb0-4147-a957-27546b657c0b/download/zz-6080672-2012-RegulatoryExcellence.pdf ; Saskatchewan, Ministry of the Economy, *Annual Regulatory Modernization Progress Report for 2015-2016*, available at http://publications.gov.sk.ca/documents/310/93580-2015-16RegulatoryModernizationProgressReportECONOMY.pdf ; *The Regulatory Accountability Act* (Manitoba), SM 2017, c. 21, s. 4, available at http://web2.gov.mb.ca/laws/statutes/2017/pdf/c02117.pdf ; *Regulations Act* (Quebec), CQLR 1986, c R-18.1, s. 5, available at http://legisquebec.gouv.qc.ca/en/pdf/cs/R-18.1.pdf ; Newfoundland and Labrador, New Brunswick, Nova Scotia and Prince Edward Island have each passed legislation creating a Joint Office of Regulatory Affairs and Service Effectiveness, available at https://novascotia.ca/regulatoryopportunity/premiers-%20charter.asp.

[8] Section 2.3, IOSCO Task Force Report on Wholesale Market Conduct, June 2017, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD563.pdf

[9] G-20, *Leaders' Statement: The Pittsburgh Summit*, available at: https://www.oecd.org/G-20/summits/pittsburgh/G-20-Pittsburgh-Leaders-Declaration.pdf.

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evidence that it is necessary for these business conduct rules to apply in particular to such a broad range of market participants.

A further principle of the Ontario Regulatory Policy states that a clear assessment of the total costs and benefits of proposed regulations should be undertaken, and should be based on the risks posed in the absence of regulation, taking into account the overall impact on the competitiveness of those subject to the regulation. While the notice accompanying the Proposed Rules includes a section on Anticipated Costs and Benefits, CMIC submits that this analysis has not taken into account a number of factors. With respect to "benefits", the analysis provides that the Proposed Rules offers protections not only to retail market participants but also to "large market participants whose derivatives losses could impact their business operations and potentially the Canadian economy more broadly". It is not clear that market participants, and in particular, "large market participants" are in need of further protection other than that already afforded to them under existing regulation. Further, the analysis provides that the Proposed Rules "fills a regulatory gap" for certain derivatives firms that are not subject to business conduct regulation and oversight. While that may be the case for some market participants, it is CMIC's view that firms representing the overwhelming majority of OTC derivatives market participants, i.e. domestic and foreign banks and swap dealers, are already subject to business conduct regulation and oversight, either through prudential regulators or under foreign business conduct rules.

In terms of "costs", CMIC strongly submits that the analysis does not take into account the additional client outreach that will be required, the associated direct costs, the challenges involved and the consequential effects. It is highly likely that derivatives dealers will need to amend existing documentation to obtain representations in order to comply with the Proposed Rules and/or would have to conduct due diligence to ensure counterparties have the status of an "eligible derivatives party" ("**EDP**"). As CMIC bank members' experiences with implementing the OTC derivatives trade reporting rules demonstrate, there are significant challenges associated with obtaining such representations from clients, especially those located outside of Canada. Certain foreign market participants, regardless of size, will only respond to requests from major jurisdictions, such as the US and Europe, which means that an inordinate amount of time is spent following-up on client outreach correspondence. Further, market participants are fatigued by the burden of regulatory compliance in multiple jurisdictions. Non-Canadian derivatives firms are increasingly weighing the burden of complying with Canadian-specific regulations in deciding to continue transacting with Canadian counterparties. While the "costs" section of the analysis recognizes the possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Rules, it cites the fact that substituted compliance will significantly reduce such compliance costs. CMIC submits that a significant reduction of such compliance costs is unlikely because foreign derivatives firms will need to spend the time and money analyzing the Canadian rules to implement and ensure compliance with the provisions for which substituted compliance has not been granted. This may dissuade them from transacting with Canadian market participants, as discussed further below under "Harmonization" on page 4.

Accordingly, it is CMIC's view that the Proposed Rules should not be implemented in Canada until a comprehensive regulatory impact assessment is completed. We submit that this is what the Ontario Regulatory Policy requires.[10] This assessment should include a detailed assessment as to the precise extent to which the Proposed Rules are duplicative, in whole or in part, of existing Canadian law, and a full cost/benefit analysis in consultation with market participants.

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[10] Ontario Regulatory Policy, *supra* note 5 at page 4 under the heading, "Regulatory Impact Assessment".

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OTC Derivatives Markets vs Securities Markets: The Notice accompanying the Proposed Rules indicates that NI 31-103 was used as a starting point for the Proposed Rules but that modifications were made to reflect the different nature of derivatives markets. In CMIC's view, the changes made do not go far enough to reflect the fundamental differences between the OTC derivatives markets and securities markets.

An OTC derivatives transaction is a bilateral, privately negotiated transaction where two parties are acting as principal and, generally speaking, both parties have obligations to each other during the term of the transaction which compels good practices. This may be contrasted with a securities transaction where one party offers an investment to a potential investor, the sale of which is effected by an intermediary. The investor does not have any further obligations to the issuer of the security. In the case of securities markets, there is perceived to be an informational imbalance between issuers and investors, which raises the need for protection of the investor by requiring prospectus-level disclosure in public offerings and certain disclosure in private offerings. In OTC derivatives markets, transactions are primarily used by individuals and corporations to hedge risks and accordingly, they are not primarily investment products but risk management products that have substantially different financial profiles, i.e. loss of principal vs. mark-to-market exposure. In addition, in most cases, the perceived informational imbalance that exists in the securities markets is not present in the OTC derivatives markets. Further, in the OTC derivatives markets, transactions are governed by internationally agreed ISDA documentation that, for the most part, is governed by New York law or English law, whereas securities transactions are not. As a result of these fundamental differences between the two markets, it is CMIC's view that some of the concepts in the Proposed Rules which were derived from NI 31-103 are not applicable or appropriate to include in the Proposed Rules. For example, as discussed in greater detail below on pages 16 and 28 three of such provisions are the Fair Terms and Pricing and the Tied Selling provisions, respectively.

In addition, CMIC recommends a three-tiered structure, instead of the proposed two-tiered structure, under which participants in the inter-dealer market would be exempt from all business conduct rules where dealers are transacting with each other. Please see our discussion below in our response to Question 4 on page 13. This three-tiered structure recognizes the differences between the OTC derivatives market and the securities market.

Finally, CMIC submits that the foreign exchange ("**FX**") market in particular should be treated differently than any other OTC derivative asset class given that the FX market is mature and transparent. Further, CMIC notes that over a two year period, FX market participants from 16 jurisdictions around the globe in partnership with 21 central banks representing the largest currency areas have already created a single, global set of best practices principles that are right-sized for the FX market (the "**FX Code of Conduct**")[11]. The FX Code of Conduct is very comprehensive, setting out 55 principles in the areas of ethics, governance, execution, information sharing, risk management and compliance and confirmation and settlement. Accordingly, any regulatory deviation from the FX Code of Conduct would result in market fragmentation. Although the FX Code of Conduct is voluntary, it has been adopted by the industry and received endorsement from the Bank of Canada.[12]

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[11] *FX Global Code*, available at: http://www.globalfxc.org/docs/fx_global.pdf.

[12] The Governors of the Global Economy Meeting (of which the Governor of the Bank of Canada is a member) endorsed the FX Code of Conduct on 25 May 2017. See http://www.bis.org/press/p170525.htm. In addition, the Bank for International Settlements' Report on Adherence to the FX Global Code dated May 2017, tenet 3, required the role of central banks "To lead by example and demonstrate their commitment to promoting and maintaining good market practice. To facilitate this, "central banks will expect that their regular FX trading counterparties adhere to the principles of the FX Code of Conduct, except where this would inhibit the discharge of their legal duties or policy functions". See http://www.bis.org/mktc/fxwg/adherence_report.pdf, pg. 4. Further, at the Canadian Foreign Exchange Committee ("CFEC") Meeting (chaired by the Bank of Canada), it was noted that "The GFXC website (www.globalfxc.org), containing the FX Global

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In fact, the Bank of Canada has indicated to a CMIC member that it would discontinue trading with any banks that do not follow the FX Code of Conduct. Therefore, CMIC submits that any derivatives firm following the FX Code of Conduct should be exempt from the Proposed Rules in connection with any FX transaction, whether or not its counterparty is an EDP. In the alternative, CMIC submits that, at a minimum, such exemption should apply in respect of physically-settled FX swaps and FX forwards. Such physically-settled transactions are exempt from the margin requirements under OSFI Guideline E-22[13] and the Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions ("**BCBS-IOSCO**") margin framework for uncleared derivatives[14] and for the same reason such transactions are exempted in such other cases, namely, such transactions amount to simply a contractually required cash payment.

Harmonization: Another fundamental difference between OTC derivatives markets and securities markets is that the OTC derivatives market is global in nature. The overwhelming majority of OTC derivatives transactions entered into by Canadian bank members of CMIC is with a non-Canadian counterparty. In addition, the Canadian OTC derivatives market represents a very small percentage of the global OTC derivatives market, based on notional amount. Therefore, the Canadian OTC derivatives markets are very dependent on global participants. This highlights the importance of having Canadian rules harmonized as much as possible with global rules, as it has been the experience of CMIC members that certain foreign market participants do not find that the benefit of changing and expanding their systems in order to accommodate unique Canadian rules outweigh the costs thereof. Harmonization with global rules, and in particular with the CFTC business conduct rules, which market participants have been complying with for a number of years, is extremely important in order to have a level playing field among market participants regardless of jurisdiction. CMIC submits that any variation from the CFTC business conduct rules will disproportionately increase implementation and compliance costs for global market participants in comparison to the relatively small size of the Canadian OTC derivatives market. This may result in global counterparties exiting the Canadian market, thereby decreasing liquidity and increasing systemic risk.

Timing of Implementation: As the Canadian Securities Administrators ("**CSA**") are aware, the CFTC has commenced a project seeking public input on simplifying and modernizing its rules, including its business conduct rules, and making them less costly to comply with ("**Project KISS**"). Consequently, it is anticipated that the CFTC rules governing OTC derivatives will be reviewed and reassessed, including its business conduct rules, although the details of any changes are not known at this time. In addition, the SEC's business conduct rules for securities based swaps are not yet in force. As the Proposed Rules will also govern securities-based swaps, we may potentially find ourselves in the situation where Canada has imposed business conduct rules with respect to certain counterparties who only transact in securities-based swaps, but such counterparties would not be subject to such business conduct rules if dealing with US counterparties. It is CMIC's view that harmonization of the Proposed Rules to US rules is critically important, and we recommend delaying the implementation of NI 93-101 until the later of the date on which the revised CFTC business conduct rules are in force and the date on which the SEC`s business conduct rules are in force.

SUBSTITUTED COMPLIANCE

Code, the FXWG Report on Adherence to the Global Code, the Statement of Commitment, the request for feedback on last look, the Terms of Reference and membership on the GFXC and other information, will be linked to the CFEC website. As previously discussed at CFEC, signing the Statement of Commitment will in future be a condition for membership of CFEC." See http://www.cfec.ca/files/minutes92.pdf, pg. 2.

[13] OSFI Guideline E-22: *Margin Requirements for Non-Centrally Cleared Derivatives* ("**OSFI Guideline E-22**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e22.aspx.

[14] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, *Margin Requirements for Non-Centrally Cleared Derivatives*, available at: http://www.bis.org/publ/bcbs261.pdf.

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It is CMIC's view that substituted compliance should be given under Section 40 to foreign derivatives dealers that are registered as swap dealers under CFTC rules and investment firms that are subject to the requirements of MiFID II[15] on a holistic basis. From an outcomes perspective and taken as a whole, CMIC submits that the business conduct rules under Dodd-Frank and under MiFID II achieve substantially the same objectives as set out under the Proposed Rules. Similarly, it is CMIC's view that substituted compliance should be given on a holistic basis to financial institutions that are regulated by OSFI and subject to OSFI Guideline B-7.[16] As an example, prudential regulators have granted substituted compliance on a holistic basis for uncleared margin requirements notwithstanding there are differences in two sets of rules, given that, taken as a whole, the rules achieve the same outcome.[17] However, the granting of such substituted compliance on a holistic basis should be done in a manner that maintains a level playing field among market participants. In other words, substituted compliance should be given on a holistic basis to both foreign derivatives dealers and Canadian financial institutions, or to neither of them in order to avoid one of them being disadvantaged over the other.

While CMIC strongly urges the CSA to use only an outcomes-based approach, taking into account the entirety of the CFTC and MiFID II rules, as well as OSFI Guideline B-7 and other prudential rules, in the alternative only, CMIC has completed Appendix A of the Proposed Rules for foreign derivatives dealers and Appendix C of the Proposed Rules for Canadian FRFIs showing which specific sections of the Proposed Rules should be given substituted compliance.

Although we may have recommended substituted compliance for certain provisions of the Proposed Rules, we have also recommended their removal in other parts of this letter. Our completion of Appendix A and Appendix C should not detract from any of our arguments below with respect to removal of provisions from the Proposed Rules. In respect of those provisions, the substituted compliance argument and completion of Appendix A and Appendix C should be viewed only as an alternative position.

It is CMIC`s view that the exemption for foreign dealers under Section 40 should not be conditional upon dealing with EDPs. If business conduct rules in a foreign jurisdiction are equivalent, it should not matter that the foreign dealer is not dealing with an EDP. It is also not clear why a derivatives dealer would not qualify for the exemption if it is in the business of trading in derivatives on an exchange or on a derivatives trading facility. Finally, CMIC submits that foreign dealers should not be required to deliver the statement required under Section 40(3)(c) in order to qualify for the exemption. Delivering this statement does not, in CMIC`s view, provide any additional protection to the derivatives party and is something that is generally covered in the applicable derivatives agreement. Accordingly, the costs associated with the increased operational burden outweigh any benefits achieved from the delivery of such a statement. Further, this type of statement is not required by the CFTC as a condition of substituted compliance. This lack of harmonization may further discourage foreign dealers from continuing to trade OTC derivatives with Canadian clients. In the alternative, if this requirement is not removed and the CSA permits foreign firms to rely on substituted compliance when facing non-EDPs, CMIC submits that this statement should only be delivered to non-EDPs, consistent with the requirement under Section 23 of the Proposed Rules. However, please further

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[15] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("**MiFID II**"), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065.

[16] OSFI Guideline B7 *Derivatives Sound Practices* ("**OSFI Guideline B-7**"), available at: http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b7_let.aspx.

[17].See Australian Prudential Regulation Authority's Prudential Standard CPS 226, available at http://www.apra.gov.au/CrossIndustry/Consultations/Documents/Final-CPS-226-September-2017.pdf.

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note our argument for deleting this requirement altogether on page 29 of this letter. A derivatives dealer that complies with the investor protection requirements under either the Proposed Rules or under a foreign regime deemed equivalent by the CSA will be providing disclosures relevant to all aspects of the relationship. Given this, CMIC's view is that this separate statement provided by foreign dealers to derivatives parties doesn't provide any additional meaningful protection.

RESPONSES TO QUESTIONS

1) Definition of "eligible derivatives party"

Q: Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Answer:

Subject to our comments below on page 13 under our response to Question #4 regarding a three-tiered structure, CMIC supports the concept of an EDP to represent sophisticated market participants.

EDP Definition

In North America, regulators have formulated two definitions to meet the needs of OTC derivatives markets: the "accredited counterparty" definition in the Derivatives Act (Quebec)[18] and the "eligible contract participant" definition in Dodd-Frank.[19] Market participants in OTC derivatives are comfortable with these definitions and have been using them for a number of years. Both of these definitions inform our comments relating to the proposed EDP definition.

In particular, we note that the business conduct requirements in Sections 63-77 of the Quebec Derivatives Act do not apply to OTC derivatives transactions between accredited counterparties. In other words, market participants who qualify as accredited counterparties are sufficiently sophisticated such that they do not require business conduct protections.[20] We wish to highlight the "accredited counterparty" definition as an effective threshold for the application of business conduct rules in Canadian OTC derivatives markets.

In contrast, we note that the definition of "permitted client" under NI 31-103 was designed for securities markets and is therefore not appropriate for or applicable to OTC derivatives in several areas discussed below.

Hedger Category

While the purpose of categorizing counterparties as either an EDP or a non-EDP under the Proposed Rules will determine the extent to which the Proposed Rules will apply to a derivatives dealer's relationship to such counterparty, it is highly likely that the overwhelming majority of large derivatives dealers will only transact with EDPs (just as many large market participants in the OTC derivatives market in Quebec, including Canadian banks, only trade with other accredited counterparties). Accordingly, CMIC submits that it is crucial that the EDP definition be broad enough to include all end-users who currently transact in OTC derivatives transactions for hedging purposes in order to ensure they continue to have the benefit of this key risk management tool.

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[18] *Derivatives Act* (Quebec), c. I-14.01 (the "**Quebec Derivatives Act**"), available at http://legisquebec.gouv.qc.ca/en/ShowDoc/cs/I-14.01

[19] Section 1a(18) of the *Commodity Exchange Act*.

[20] Section 7 of the Quebec Derivatives Act provides that certain sections of the Act, including those relating to registration, business conduct and qualifications, do not apply to activities or transactions in OTC derivatives involving accredited counterparties only.

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As noted above, the securities markets are fundamentally different from the OTC derivatives markets, mainly because OTC derivatives transactions are primarily risk management transactions and are entered into by most end-users in order to hedge risks. Accordingly, a hedger category is very useful to small and medium sized businesses, as well as individuals, that do not exceed the thresholds set out in clauses (m) and (n) of the current draft of the definition of EDP. However, such businesses need to hedge their foreign currency or interest rate risks in respect of their commercial operations. For example, a large number of small Canadian companies tend to export goods and services to, or import supplies from, the US as part of their business model. Such companies, regardless of their size, need to routinely hedge their foreign exchange risk. Hedging needs depend on, among other things, the location of a company's customers, its cash flow levels, and interest rate mismatches among its assets and liabilities; it is not correlated to the size of its balance sheet. Under this example, the only possibility for a company to hedge its risks is to maintain access to the OTC derivatives market since such market can provide bespoke products in order to exactly match the size and timing of the company's cash flows. No market other than the OTC derivatives market can provide such a tailored risk management solution. It is telling that both the "accredited counterparty" definition in the Quebec Derivatives Act and the "eligible contract participant" definition in Dodd-Frank include hedger categories.

Threshold for non-Individuals

We also wish to mention the fact that the threshold level for non-individuals under clause (m) of the EDP definition is, in CMIC's view, too high. CMIC strongly submits that there should be a lower asset threshold of $10 million. A lower threshold is consistent with the definition of "accredited counterparty" under the Quebec Derivatives Act[21] and with the "eligible contract participant" definition under Dodd-Frank.[22]

Permitted Client Definition

As indicated previously, derivatives firms will need to conduct a client outreach in order to ensure that representations received from clients are current and conform to the new requirements under the Proposed Rules. In order to reduce this burden, CMIC recommends that the term, "eligible derivatives party" include as an additional category, all entities that are "permitted clients" under NI 31-103. In CMIC's view, parties qualifying as "permitted clients" in the exempt securities markets are sophisticated enough to be treated as an EDP and therefore do not require the same protection as non-EDPs. Additionally, adding this additional category will allow derivatives firms who already have "permitted counterparty" representations from their counterparties to rely on such representations and eliminate such counterparties from their client outreach efforts.

Q: Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

Answer:

CMIC recommends including individuals with minimum assets of $5 million in the EDP definition, consistent with the "accredited counterparty" definition in the Quebec Derivatives Act.[23] Some may

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[21] This threshold is calculated as "cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than $10,000,000" (*Derivatives Regulation*, c. I-14.01, r.1, s. 1).

[22] $10 million in total assets, or, if hedging a minimum net worth exceeding $1 million

[23] This threshold is calculated as "cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than" $5,000,000 (*Derivatives Regulation*, c. I-14.01, r.1, s. 1). The "eligible contract participant" definition in Dodd-Frank also includes individuals with amounts invested on a discretionary basis, the aggregate of which is in excess of $10 million, or if managing the risk associated with an asset or liability incurred, $5 million.

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argue that individuals should not be included as an EDP as there may be some concern that they may not be sophisticated enough, regardless of how many assets they own. Further, some may argue that the amount of a person's total assets is not truly indicative of its sophistication and level of understanding. While that may arguably be the case, a minimum total asset test is also premised on the fact that the individual has the ability to withstand financial losses, has the financial resources to obtain expert advice or otherwise protect themselves through contractual negotiation. In addition, using total assets as an indicator of sophistication is a clear and objective way in which to determine whether an individual is an EDP. Therefore, it is CMIC's view that it is entirely appropriate for individuals with minimum assets of $5 million to be included in the EDP definition. Please note that the threshold recommendations set out in the answers to this Question 1 are to be considered together and not individually.

With respect to individuals, CMIC notes that Section 7(2) of the Proposed Rules requires that a waiver must be obtained by a derivatives firm from an individual that is an EDP if such derivatives firm wishes to be exempt from the provisions set out in Section 7(1)(a)-(d) as they relate to such individual. For the reasons set out in the preceding paragraph with respect to the sophistication and level of understanding of high net worth individuals, CMIC submits that such a waiver is not necessary. In addition, no other current derivatives rule in Canada dealing with the exemption of protections under securities or derivatives legislation requires such a waiver.[24] However, If the CSA continues to require such a waiver, CMIC submits that it should only be given once and the onus for updating such waiver should be placed on the individual in the event the individual wishes to revoke its waiver.

Please also see our comments below on page 24 and 23 where we discuss whether clearing agencies and government entities should be included in the definition of EDP.

2) Alternative definition of "eligible derivatives party"

Q: Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

Answer:

No, CMIC submits that it is not appropriate to use the definition of "institutional client" as proposed in CSA Consultation Paper 33-404. As noted above, CMIC believes that regulators should have regard to definitions formulated for the OTC derivatives market, specifically in respect of the thresholds and the inclusion of a hedger exemption. We also note that the "institutional client" definition excludes individuals, while CMIC is supportive of the inclusion of high net worth individuals in the definition of EDP.

3) Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"

Q: If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for

[24] For example, see: (i) the "qualified party" definition in British Columbia under Blanket Order 91-501 *Over-the-Counter Derivatives*, available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/91-501__BCI_/; (ii) the "qualified party" definition in Alberta under Blanket Order 91-506 *Over-the-Counter Trades in Derivatives*, available at: http://www.albertasecurities.com/Regulatory%20Instruments/4980944%20_%20Blanket_Order_91-506_Over-the-Counter_Trades_in_Derivatives.pdf; and (iii) the "accredited counterparty" definition in Quebec under the Quebec Derivatives Act.

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that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?

Q: Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

Answer:

With respect to the knowledge and experience requirement in clauses (m) and (n) of the definition of EDP, CMIC submits that the specific knowledge and experience of the counterparty should not be part of the EDP definition. Instead, it should be sufficient for the determination of a party's status to be based on a "bright line" test, such as the total assets of a party. Having a bright line financial resources test is consistent with the approach taken in other circumstances, for example, with respect to whether a party is an "accredited investor" under NI 45-106[25] and whether a party is a "permitted client" under NI 31-103. In neither of those cases is proficiency assessed and/or attested to as part of the determination as to whether the investor is an "accredited investor" or a "permitted client".

However, if the CSA does not accept CMIC's position as set out in the previous paragraph, it is CMIC's view that the knowledge and experience requirement should apply generally and not to a specific type of transaction. CMIC believes that making this determination on a product-by-product basis would be too granular and this is not something that is done when determining whether an investor is an "accredited investor" or a "permitted client". In addition, it is not practical for derivatives firms to keep track of the status of a counterparty on a product-by-product basis. The status of the counterparty is determined at the beginning of the relationship (or once the Proposed Rules become effective) and will likely be done through written representations. If the status of a counterparty is linked to the knowledge and experience with respect to a specific product, it will be too cumbersome and onerous to keep track of which representations have been received for each product, and then require updated written representations in the event the counterparty decides to enter into any new product. This could lead to these types of counterparties losing access to the OTC derivatives market if it becomes too difficult to implement this requirement. Foreign dealers or advisers in particular may determine that the significant cost of implementing a system specific to Canadian counterparties in order to categorize their EDP status by product type is not worth the benefit of trading with these counterparties. Finally, if the CSA requires this determination on a specific product-by-product basis, the Proposed Rules should describe product types broadly and based only on underlying asset, for example, commodity transactions, interest rate transactions, foreign exchange transactions, credit transactions and equity transactions.

CMIC is also concerned that clauses (m) and (n) of the EDP definition require that written representations must be received from the counterparty. While receiving such representations would be ideal with respect to ensuring that a counterparty qualifies as an EDP, as discussed above, the likelihood of a derivatives dealer receiving all such representations from all counterparties that are required to give them as part of a client outreach is extremely remote. Further, requiring such written representations places an additional burden on clients who are required to make such representations as they may need to engage legal counsel to advise them. CMIC recommends that the wording of these provisions be changed to allow for a derivatives firm to otherwise confirm, acting reasonably, that the counterparty satisfies the financial threshold test, and, if not removed, the knowledge and experience tests.

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[25] National Instrument 45-106 *Prospectus Exemptions* ("**NI 45-106**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy4/PDF/45-106__NI___October_29__2016/.

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4) Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties

Q: Do you agree with the two-tiered approach to investor/customer protection in the Instrument? Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

Answer:

Generally speaking, CMIC agrees with the approach that a majority of the Proposed Rules should not apply to an EDP, and CMIC is of the view that there are no additional requirements that a derivatives firm should be subject to when dealing with an EDP. In fact, CMIC submits that the two-tiered approach does not go far enough and recommends that an exemption from the application of the Proposed Rules be given to all derivatives dealers when transacting with another derivatives dealer or with a clearing agency[26] (such exemption, the "**Inter-dealer Exemption**", and such approach is referred to in this letter as a "**three-tiered structure**"). As discussed above, the OTC derivatives market is fundamentally different from the securities market. It is a well-established market that has been functioning without any major issues in Canada. CMIC submits that provisions of the Proposed Rules, such as the "know your client" requirements and the "fair dealing" requirements should not apply to other dealer counterparties. Derivatives dealers have been comfortable transacting with each other under existing prudential rules or other laws (such as anti-money laundering laws and anti-terrorist financing laws) and, in CMIC's view, do not need the added "protection" of the Proposed Rules.

Q: Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

Answer:

In response to this second question, we have described circumstances where the Proposed Rules do not adequately account for current institutional OTC derivatives trading practices when discussing specific sections of the Proposed Rules. For example, in responding to question 7 below with respect to "fair terms and pricing", we describe how such provisions are not appropriate and will place an unreasonable burden on derivatives dealers and unnecessarily discourage trading in OTC derivatives in Canada.

Q: Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

Answer:

With respect to whether the two-tiered approach should apply to a derivatives adviser that is advising an EDP, it is CMIC's view that it should. Section 7(3) of the Proposed Rules currently provides that the two-tiered approach would not apply where a portfolio manager is making decisions in respect of a managed account on behalf of an EDP such that the portfolio manager would need to comply with all of the requirements under the Proposed Rules. CMIC submits that such an approach is not warranted.

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[26] See further discussion of clearing agencies on page 17 of this letter.

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The portfolio manager has fiduciary obligations to each underlying EDP. In addition, the parties are sophisticated market participants and EDPs have sufficient financial resources to both purchase professional advice and to protect themselves through contractual negotiation with the portfolio manager. Indeed, the parties would typically enter into an investment management (or similar) agreement that clearly sets out the contractually negotiated terms in respect of the managed account arrangement. In CMIC's view, the underlying EDPs should not be treated like non-EDPs simply because they have chosen to purchase professional advice via a managed account arrangement. It is unclear why an EDP that is not in a managed account relationship which has the financial resources to purchase professional advice but chooses not to when transacting with a dealer directly (which is not uncommon) is deemed not to require the extra protections afforded by the Proposed Rules, and yet an underlying EDP that enters into a contractually negotiated agreement in a managed account situation does. The significant compliance costs associated with the inclusion of Section 7(3) are not, in our view, proportionate to the benefits.

If the CSA does not agree with the above approach, CMIC recommends, as an alternative position only , that (i) the EDP should be given the option of electing out of some or all of the protections given to non-EDPs under the two-tiered structure, or (ii) if a managed account is for an EDP that is a regulated entity, such as a pension plan, Section 7(3) would not apply in such circumstances.

5) Business trigger guidance

Q: Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

Answer:

CMIC submits that the business trigger guidance is one of the most important aspects of the Proposed Rules as this will clarify whether a party will be subject to the business conduct obligations. The definition of "derivatives dealer" and the Companion Policy refer to a person or company being in scope under the Proposed Rules if they are in the business of "trading" derivatives. In CMIC's view, this reference to "trading" should be deleted and replaced with the word "dealing", which is a more accurate reflection of what a derivative dealer does.

The Companion Policy also refers to the fact that a person or company that meets the definition of "derivatives adviser" or "derivatives dealer" in a local jurisdiction is subject to the instrument in that jurisdiction. We assume this means that the counterparty of such person or company is physically located in a local jurisdiction at the time a trade is negotiated or executed and the Proposed Rules would apply only to counterparties in such local jurisdiction. In other words, the jurisdiction of incorporation or head office or principal place of business of such counterparty is not relevant to the analysis of whether the derivatives dealer is "in a local jurisdiction". We further assume that the obligations under these business conduct rules do not apply when a derivatives firm faces a counterparty that is not located in Canada. Imposing these conduct requirements on a Canadian firm transacting with a counterparty located in a foreign jurisdiction would place that Canadian firm at a competitive disadvantage relative to other firms operating in that jurisdiction, and would require them to obtain Canadian specific KYDP information and documentation in relation to a foreign counterparty's EDP status which the counterparty would not have to provide to other non-Canadian firms. We submit that regulators in each foreign jurisdiction are best positioned to determine the business conduct rules that are required to protect counterparties located in their jurisdiction. Finally, we also assume that the activities of a person or company in one jurisdiction should not affect the characterization of its activities in another jurisdiction. For example, a US company registered as a US swap dealer is clearly in the business of dealing in derivatives in the US. However, if the only OTC derivatives transactions it enters into in Canada are with a Canadian bank for purposes of

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hedging its Canadian dollar exposure, CMIC submits that such US swap dealer would not be a "derivatives dealer" in Canada. CMIC strongly recommends that these three jurisdictional points are expressly clarified in the Companion Policy.

In terms of the substantive guidance provided in the Companion Policy, it is CMIC's view that the guidance does not appropriately or clearly describe the circumstances where a person or company would be considered a derivatives dealer or derivatives adviser. First and foremost, the only way in which a person or company can be a "derivatives dealer" is if it is in the business of dealing in derivatives, or holding itself out as dealing in derivatives. In CMIC's view, this means that such person or company makes a two-way market in OTC derivatives or routinely quotes prices at which they would be willing to transact. That is the only way in which a person or company can be a "derivatives dealer" and this fact should be highlighted in the Companion Policy. All the other factors listed in the Companion Policy, other than entering into transactions frequently, are simply factors to be considered which may evidence that a person or company makes a market in OTC derivatives. With respect to the frequency of entering into transactions, it is CMIC's view that the frequency of transactions is irrelevant to whether a person or company is making a market in OTC derivatives, and should be removed from this guidance. Frequent or regular hedging or speculative transactions may be undertaken by a corporate end-user, but in CMIC's view, that activity should not mean that such corporation is a derivatives dealer, even if it profits from such speculative transactions.

6) Fair Dealing

Q: Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

Answer:

CMIC members are very committed to fair dealing as a matter of culture and reputational risk and bank members of CMIC are also subject to existing laws and regulatory rules that mandate fair dealing. In addition, member banks have a record of commitment to managing their affairs and dealing with their counterparties in a fair manner. As discussed below, there is already a framework in place that covers the fair dealing obligation and it is working well. Further, there have been no appreciable or material examples of banks or other derivatives firms in Canada violating existing fair dealing rules. CMIC submits that this is an example of how the need for regulation of this particular issue has not been clearly identified and yet rules are being proposed to address a perceived need, contrary to the principles under the Ontario Regulatory Policy. The current framework relies on OSFI Guideline B-7, public interest powers (for example, Section 127 of the Ontario Securities Act[27]) and statutory powers of securities regulators to deal with fraud and with misleading or untrue statements in connection with derivatives transactions (for example, Sections 126.1 and 126.2 under the Ontario Securities Act). In addition to statutory law, common law recognizes the general organizing principle of good faith and honest performance under contracts.[28]

The introduction of an express statutory duty to act "fairly" could give rise to negative unintended consequences. The derivatives dealer/counterparty relationship is not a fiduciary relationship in the normal course nor do duties of good faith apply to the negotiation of transactions at common law (although, as noted above, they do apply to some extent to the exercise of contractual discretionary

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[27] *Securities Act* (Ontario), R.S.O. 1990, c. S.5 (the "**Ontario Securities Act**"), available at: https://www.ontario.ca/laws/statute/90s05.

[28] See *Bhasin v. Hrynew*, 2014 SCC 71 ("**Bhasin**"), available at: https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/14438/index.do. In Bhasin, the Supreme Court of Canada recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result of Bhasin, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest performance, which cannot be excluded by the terms of an agreement.

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rights as a result of the Bhasin case). CMIC submits that having a flexible fair dealing model that changes depending upon the sophistication of a counterparty and the context creates transactional uncertainty.

In the alternative, if the CSA does not agree that the fair dealing provisions should be deleted, CMIC submits that Section 8 of the Proposed Rules should be harmonized with Dodd-Frank. Under Dodd-Frank, a swap dealer must communicate in a fair and balanced manner based on principles of fair dealing and good faith.[29] Further, Dodd-Frank does not place a statutory obligation on the individual acting on behalf of a derivatives firm, which, in our view, is the correct approach. Placing liability on the individual is, in CMIC's view, overly broad and not consistent with the approach taken by the CFTC or in Europe under MiFID II. Accordingly, CMIC submits that Section 8 should be harmonized with Dodd-Frank but at a minimum, Section 8(2) of the Proposed Rules should be deleted.

With respect to the requirement in Section 8(3) of the Proposed Rules, CMIC submits that allocating transaction opportunities fairly among derivatives parties by derivatives advisers is not an applicable concept in the OTC derivatives markets. Most transactions are bespoke for a particular derivatives party and is not something that would or should be allocated to another derivatives party. Accordingly, in CMIC's view, Section 8(3) of the Proposed Rules should be deleted.

7) Fair terms and pricing

Q: Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

Answer:

In CMIC's view, the fair terms and pricing provision under Section 19 of the Proposed Rules is not appropriate in the context of the OTC derivatives market. Since these are privately negotiated, bilateral, bespoke transactions, there is no simple quick way to price all the components of a trade. Therefore, there is no "fair" price in the traditional meaning of the term. The "fair" price will be whatever is agreed upon between the two parties, bearing in mind the competitive nature of the industry. The end-user counterparty is actually, usually, in the best position to determine the best price for a transaction since it has the ability to solicit quotes from other derivatives dealers. Variations in prices quoted by different dealers could simply mean that a dealer's internal costs, including liquidity costs, capital charges and related hedging costs, are higher or lower and may be affected by market volatility, so it is not the case that they are not quoting a "fair price".

It should be noted (and perhaps, quite telling) that there is no comparable provision included under the CFTC rules nor under MIFID II. For this reason, and the reasons stated in the previous paragraph, it is CMIC's view that Section 19 should be deleted. It is not clear what is meant by "fair terms" in the context of OTC derivatives. This aspect of the Proposed Rules creates a new cause of action that is inappropriate in the competitive derivatives market and fails to recognize that existing remedies are available where there has been inappropriate conduct by way of fraud or misrepresentation. These types of existing legal remedies are operating properly to regulate activity and ensure proper allocation of risk. Creating such a new cause of action would disrupt the existing allocation of legal and operational risk and does so in a manner that does not respond to any existing problem. In fact, CMIC submits that imposing a duty to provide a "fair" price will have the unintended consequence of opening the door to significant unnecessary litigation where, in hindsight, the outcome of the trade was not as the counterparty expected (or hoped) it would be. We are dealing with, in the main, a wholesale market between sophisticated parties.

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[29] See 17 CFR Part 23, s. 23.433.

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8) Derivatives Party Assets

Q: National Instrument 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party. Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

Answer:

As currently drafted, it is CMIC's view that Division 2 of Part 4 should not apply in respect of an EDP, except with respect to Section 24 of the Proposed Rules. If a derivatives firm is subject to the requirements under NI 94-102[30] (and complies with, or is exempt from, those requirements), it should not be required to comply with the terms of Division 2 of Part 4.

However, in CMIC's view, it is not appropriate to include provisions relating to how "derivatives party assets" are held, used or invested in an OTC derivatives business conduct rule. The only time that a derivatives dealer, acting as principal, will be "holding" derivatives party assets is if the assets constitute margin[31] under the terms of the particular OTC derivatives transaction (or under a master agreement governing such transaction). This is different than client assets held by a securities dealer, since those assets may include securities held by the securities dealer for safekeeping, in addition to margin.

For OTC derivatives transactions, CMIC submits that Division 2 of Part 4 should be re-written to clearly indicate that a derivatives dealer may re-hypothecate margin received from its counterparty as long as such counterparty consents to such re-hypothecation, or the dealer is otherwise permitted to re-hypothecate pursuant to the terms of an applicable margin agreement. This ability to re-hypothecate would be subject to any segregation requirements under other rules or regulations governing OTC derivatives transactions, such as NI 94-102 in the context of cleared transactions, OSFI Guideline E-22, the provincial margin rules for uncleared transactions (once published), and any other specific rule or regulation governing a specific type of counterparty, such as NI 81-102[32]. If the CSA were to restrict this right to re-hypothecate, it would have significant pricing and liquidity implications for market participants as the majority of OTC derivatives transactions are priced assuming this right to rehypothecate will be available (subject to the above-referenced margin rules). This right to re-hypothecate with consent is consistent with European rules under MiFID II[33] and with CFTC rules.[34] If the Proposed Rules were to be re-written in such manner, it is CMIC's view that Division 2 of Part 4 would apply whether or not the counterparty is an EDP.

As noted in the previous paragraph, CMIC is of the view that Division 2 of Part 4 should only deal with the ability to re-hypothecate a counterparty's assets delivered to the derivatives dealer as margin. If the counterparty and the derivatives dealer bilaterally agree to segregate such margin, they can also

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[30] National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* ("**NI 94-102**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/94-102__NI___July_4__2017/.

[31] The term "margin" is deemed to also include a reference to "collateral" and includes property transferred under an absolute transfer credit support agreement, as the context requires.

[32] National Instrument 81-102 *Investment Funds* ("**NI 81-102**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy8/PDF/81-102__NI___March_8__2017/.

[33] See MiFID II, a. 16(8).

[34] See 17 CFR Part 23, s. 23.701. A customer has the right to require that a swap dealer segregate initial margin. This right does not extend to variation margin. There are no other restrictions on a swap dealer's right to re-hypothecate if it has its counterparty's consent.

agree to any restrictions relating to the use or investment of such margin. While there are investment restrictions under NI 94-102 and under E-22, those rules are primarily concerned with systemic risk. CMIC submits that it is unnecessary for the business conduct rules to deal with such issues which can be adequately addressed by way of contract. This is another example of how the need for regulation of this particular issue has not been clearly identified, resulting in a solution being presented under the Proposed Rules for an unidentified problem, contrary to one of the principles under the Ontario Regulatory Policy.[35]

It is not clear why the Proposed Rules use the broadly defined term "derivatives party assets" rather than "margin" in Sections 26-28, which would be more in line with the approach taken in Part 2 of NI 94-102. At a minimum, CMIC submits that the qualification "relating to derivatives transactions" should be incorporated into the definition itself as the definition is too broad and could include assets unrelated to the derivatives transaction. It is also not clear how Sections 26-28 of the Proposed Rules are intended to apply to the activities of a portfolio manager acting on behalf of a managed account, where discretionary authority has been contractually granted to the adviser in respect of the use and investment of a portfolio of assets that involves more than but includes the use of derivatives. It would be helpful if this could be explained.

9) Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. **Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?**

Answer:

It is CMIC's view that Sections 21, 22 and 30 of the Proposed Rules should align with the CFTC rules under Dodd-Frank. The CFTC rules provide that a swap dealer is required to disclose to its counterparty the "methodology and assumptions" used to prepare the daily mark and any material changes during the term of the swap, provided that the swap dealer is not required to disclose to the counterparty any confidential or proprietary information about any model it may use to prepare the daily mark.[36] It is unclear whether "inputs and assumptions" would be equivalent to "methodology and assumptions", but arguably, "inputs" implies that more specific information will be required to be provided as opposed to only the "methodology" as required under the CFTC rules. CMIC recommends that the approach taken by the CSA under the Proposed Rules be aligned with the CFTC rules on this point, so as to achieve a harmonized result.

10) Senior derivatives managers

Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on "senior derivatives managers", and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

Answer:

[35] See the discussion of the Regulatory Policy on page 2.

[36] See 17 CFR Part 23, s. 23.431(d).

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Compliance is a top priority for CMIC members, including ensuring that the right persons within the organization are monitoring and enforcing compliance matters and that responsibility for compliance matters is properly and clearly allocated. CMIC members are very focused on ensuring a "culture of compliance". There is robust existing regulatory guidance on establishing effective compliance regimes in Canada, and Canadian institutions are internationally well regarded in this regard.

With respect to CMIC member firms that are FRFIs, the RCM Guideline[37] provides that the Chief Compliance Officer ("**CCO**") should be responsible for assessing the adequacy of, adherence to and effectiveness of the FRFI day-to-day controls, and for providing an opinion to the board whether, based on the independent monitoring and testing conducted, the Regulatory Compliance Management ("**RCM**") controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide. Furthermore, OSFI Guideline E-21[38] clearly outlines the "three lines of defence" approach to compliance as the recommended approach:

> *"FRFIs should ensure effective accountability for operational risk management. A "three lines of defence" approach, or appropriately robust structure, should serve to delineate the key practices of operational risk management and provide adequate objective overview and challenge. How this is operationalized in practice in terms of the organisational structure of a FRFI will depend on its business model and risk profile."*

Specifically, the "three lines of defence" is stated by OSFI to be:

> First Line of Defence
>
> The business line – the first line of defence – has ownership of risk whereby it acknowledges and manages the operational risk that it incurs in conducting its activities. The first line of defence is responsible for planning, directing and controlling the day-to-day operations of a significant activity/enterprise-wide process and for identifying and managing the inherent operational risks in products, activities, processes and systems for which it is accountable.
>
> Second Line of Defence
>
> The second line of defence is the oversight activity that objectively identifies, measures, monitors and reports operational risk on an enterprise basis. It consists of a collection of operational risk management activities and processes, including the design and implementation of the FRFI's framework for operational risk management. The second line of defence is best placed to provide specialized reviews related to the FRFI's operational risk management. In addition, it should be noted that other staff/corporate areas of the FRFI (e.g. compliance) may also be deemed part of the second line of defence.
>
> A key function required of the second line of defence is to provide an objective assessment of the business lines' inputs to and outputs from the FRFI's risk management (including risk measurement/estimation), and to establish reporting tools to provide reasonable assurance that they are adequately complete and well-informed.
>
> Third Line of Defence

[37] OSFI Guideline E-13 *Regulatory Compliance Management* (the "**RCM Guideline**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e13_let_2014.aspx.

[38] OSFI Guideline E-21 *Operational Risk Management* ("**OSFI Guideline E-21**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e21.aspx .

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> The internal audit function is charged with the third line of defence. The third line of defence should be separate from both the first and second lines of defence, and provide an objective review and testing of the FRFI's operational risk management controls, processes, systems and of the effectiveness of the first and second line of defence functions. The third line of defence is best placed to observe and review operational risk management more generally within the context of the FRFI's overall risk management and corporate governance functions. Objective review and testing coverage should be sufficient in scope to verify that the operational risk management framework has been implemented as intended and is functioning effectively.

The requirements proposed under Sections 33 and 34 of the Proposed Rules differ significantly from existing best practices. The proposed regime is at odds with the existing compliance regime structure, as the existing regime is focused on the key role of the CCO as having ultimate responsibility for oversight of monitoring and reporting on compliance matters, and is premised on the CCO being independent from the lines of business. Practically speaking, the definition of "senior derivatives manager" at the desk level would result in a significant number of individuals who are principally responsible for managing one or more derivatives business desks at a large derivatives firm. This makes it extremely difficult to provide consistent oversight and reporting for all business lines and would result in oversight fragmentation. The current regime does not have that result.

There is, in the view of CMIC members and as reflected in existing regulatory guidance, an inherent conflict of interest in having a senior manager attest to compliance within his or her business line. While first-line business units are responsible for complying with applicable laws and regulations, the second-line compliance group performs the independent monitoring and reporting function. Compliance is best achieved by having a person outside of the business unit, such as the CCO, having ultimate responsibility for oversight of monitoring and reporting on compliance matters, as reflected in the "three lines of defence" approach to compliance.

The proposed regime also requires senior managers to submit a report to the Board of Directors. It is not, in the view of CMIC, appropriate for senior managers to interact with the Board of Directors at this level, given the number of persons in this role and their potentially conflicting and limited viewpoints. Requiring trading desk-level compliance and reporting is, in the view of CMIC, too granular to be effective.

In fact, it is CMIC's strongly-held view that the proposed senior manager compliance regime in the Proposed Rules would create a serious risk of not being able to ascertain who is responsible for oversight of monitoring and reporting on compliance matters. This is the risk that both regulators and legislators in both the UK and Hong Kong were seeking to address but which is not present under existing Canadian rules and regulations.

Finally, the proposed requirements create a unique element to Board compliance reporting as derivatives businesses are required to certify compliance directly. The infrastructure to support that unique form of certification globally will require significant change to current processes.

International Regimes

The compliance and risk management function under NI 93-101 is imposed upon senior derivatives managers, being the business persons responsible for different business units; under CFTC rules, by contrast, compliance is overseen by a chief compliance officer, and risk management is overseen by a risk management unit, all of which would be consistent with OSFI's approach as seen in its RCM Guideline.

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Under NI 93-101, senior derivatives managers are responsible for supervision, for promoting compliance and for remedying non-compliance within their business unit, and are required to report to the board of directors on such compliance matters at least once per year; by comparison, CFTC rules require the appointment of a compliance officer that oversees compliance matters, and that is responsible for reporting to the board of directors or other senior officers at least once per year.

While the U.K. Financial Conduct Authority's Senior Managers and Certification (SM&CR) regime (the "**UK Regime**") and the Hong Kong Securities and Futures Commission's Measures for Augmenting the Accountability of Senior Management (the "**HK Regime**") also impose obligations on senior derivatives managers, they originate from a very different context.

The UK Regime was put in place as a result of recommendations made by the Parliamentary Commission on Banking Standards ("**PCBS**") in 2013, aiming to improve standards in financial services following the LIBOR crisis. The PCBS found that lack of individual accountability contributed to the LIBOR crisis.[39]

> "One of the most dismal features of the banking industry to emerge from our evidence was the striking limitation on the sense of personal responsibility and accountability of the leaders within the industry for the widespread failings and abuses over which they presided. Ignorance was offered as the main excuse. It was not always accidental. Those who should have been exercising supervisory or leadership roles benefited from an accountability firewall between themselves and individual misconduct, and demonstrated poor, perhaps deliberately poor, understanding of the front line. Senior executives were aware that they would not be punished for what they could not see and promptly donned the blindfolds. Where they could not claim ignorance, they fell back on the claim that everyone was party to a decision, so that no individual could be held squarely to blame—the Murder on the Orient Express defence. It is imperative that in future senior executives in banks have an incentive to know what is happening on their watch—not an incentive to remain ignorant in case the regulator comes calling."

Accordingly, the PCBS recommended changes to ensure additional individual responsibility:

> "The Commission recommends that the Approved Persons Regime be replaced by a Senior Persons Regime. The new Senior Persons Regime must ensure that the key responsibilities within banks are assigned to specific individuals who are aware of those responsibilities and have formally accepted them. The purposes of this change are: first, to encourage greater clarity of responsibilities and improved corporate governance within banks; second, to establish beyond doubt individual responsibility in order to provide a sound basis for the regulators to impose remedial requirements or take enforcement action where serious problems occur. This would not preclude decision-making by board or committee, which will remain appropriate in many circumstances. Nor should it prevent the delegation of tasks in relation to responsibilities. However, it would reflect the reality that responsibility that is too thinly diffused can be too readily disowned: a buck that does not stop with an individual stops nowhere."[40]

The context of the UK regime therefore differs significantly from the Canadian context, where there has not been any such crisis of confidence in financial firm culture and governance.

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[39] Parliamentary Commission on Banking Standards, "Changing banking for good", available at https://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/2704.htm.

[40] *Ibid.*

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Another rationale that underlies the UK Regime is the lack of clarity that existed as to responsibility for compliance matters prior to the enactment of the regime, as noted numerous times by the PCBS in its report:

> "723. Banks have a set of obligations that are externally imposed, through general law and specifically through regulatory requirements. These must be adhered to by everyone in the bank. In addition to the mandatory legal obligations, banks set their own control standards, relating to their overall business strategy, that they also need to ensure are being adhered to. The responsibility for making sure that there are no breaches of any of the internally or externally imposed requirements lies with all who work in the bank. **The evidence suggests that the role of compliance is hopelessly confused.**"[41] [our emphasis]

The UK approach to compliance accordingly appears not to have been well developed, clear and prescriptive prior to the enactment of the UK Regime. In contrast, the existing Canadian regime under the RCM Guideline and OSFI Guideline E-21 delineates clear and detailed responsibility and duties.

Similarly, the HK Regime also originated from a different context.

> "The key concern that appears to be driving this new initiative is that the SFC doesn't always know which individuals are responsible for key decisions, many of which may be taken by executives based outside Hong Kong. The circular quotes Principle 9 of the SFC's existing Code of Conduct, which states that the senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. In determining where responsibility lies, and the degree of responsibility of a particular individual, regard shall be had to that individual's apparent or actual authority in relation to the particular business operations….
>
> In other words, "*unless we know who to the point the finger at we can't do our job as regulator as effectively as we need to.*" "[42]

As is the case for the UK Regime, the context of the HK Regime differs from the Canadian context, as decision-makers in Canadian firms are typically located in Canada, unlike Hong Kong. Furthermore, in Canada, compliance responsibility is clearly ascribed so there is no similar concern that it is difficult to identify where the responsibility lies, pursuant to the RCM Guideline and OSFI Guideline E-21, including the "three lines of defence" approach.

Australia has recently proposed a banking executive accountability regime in order to strengthen the accountability of senior executives and directors in the banking industry. The responsibility for implementing this regime lies with the Australian Prudential Regulatory Authority (APRA), and focuses only on the prudential aspect, and not on the market conduct aspect, of management accountability. It therefore appears that this accountability regime will, if implemented, largely follow the OSFI approach as opposed to the senior derivatives manager approach under the Proposed Rules.

11) Exemptions

Q: Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

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[41] *Ibid.*

[42] Francis Kean, Willis Towers Watson, "Hong Kong to introduce new "Senior Managers Regime", available at http://blog.willis.com/2017/01/hong-kong-to-introduce-new-senior-managers-regime/.

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Answer:

See our discussion under the heading, "Substituted Compliance" on page 7, as well as the completed Appendix A and Appendix C (attached as Schedules A and B, respectively, to this letter) which set out the relevant sections of the Proposed Rules for which CMIC recommends that substituted compliance should be granted, along with the corresponding foreign law and domestic law, as applicable.[43] CMIC will not be providing commentary with respect to the exemptions under Section 41 (Investment Dealers) and Section 44 (Foreign Derivatives Advisers) under the Proposed Rules.

ADDITIONAL COMMENTS

Quebec Derivatives Act

CMIC is concerned that Sections 63-77 of the Quebec Derivatives Act and the Proposed Rules impose duplicative business conduct requirements on dealers and advisers in respect of OTC derivatives transactions that are not between accredited counterparties. We note that the Proposed Rules do not provide for any mechanism to achieve substituted compliance in respect of the Quebec Derivatives Act (other than for Canadian financial institutions, which typically trade OTC derivatives with only accredited counterparties).

In respect of OTC derivatives transactions between accredited counterparties, CMIC is concerned that the Proposed Rules may impose business conduct requirements notwithstanding that Section 7 of the Quebec Derivatives Act clearly exempts those same transactions from the equivalent business conduct requirements in the Quebec Derivatives Act. For example, if a Canadian bank is transacting with an accredited counterparty that is not an EDP, Section 11 of the Proposed Rules would impose suitability requirements even though Section 7 of the Quebec Derivatives Act exempts suitability requirements set out in Section 65 of the Quebec Derivatives Act. CMIC believes that the Proposed Rules are inconsistent with the Quebec Derivatives Act insofar as the Proposed Rules impose obligations that are equivalent to those expressly exempted by Section 7 of the Quebec Derivatives Act.[44]

Exclusion for Government Entities, etc.:

CMIC requests that the CSA clarify the scope of the exclusion for government entities contemplated under Section 6 of the Proposed Rules. In CMIC's view, it is unclear from the drafting of Section 6 whether it would have the effect of (i) excluding persons from complying with the obligations under the Proposed Rules whenever such persons are transacting with government entities, central banks and international organizations, (ii) excluding government entities, central banks and international organizations from complying with the obligations under the Proposed Rules, or (iii) both (i) and (ii). CMIC notes that there are several government entities listed under paragraphs (g) and (h) of the EDP definition under Section 1 of the Proposed Rules, and accordingly, it would appear that persons that are transacting with government entities would be required to comply with at least some of the obligations under the Proposed Rules. This means that Section 6 excludes government entities, central banks and international organizations only from complying with the obligations under the Proposed Rules and does not exempt derivatives firms from such obligations when facing government entities, central banks and international organizations. This interpretation is consistent with CFTC rules where swap dealers are required to comply with the obligations under the CFTC rules when transacting with government entities, which are referred to as "special entities" under the

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[43] See also the draft Guideline issued by OSFI for Derivatives Sound Practices for Federally Regulated Private Pension Plans.

[44] Section 5(2) of the *Regulations Act* (Quebec) c. R-18.1 requires a proposed regulation to be in harmony with existing acts and regulations.

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CFTC rules. It is CMIC's view that this interpretation should be confirmed and clarified in the Companion Policy.

In addition, CMIC submits that the entities contemplated under the Section 6 exclusion should be expanded to include (i) an express reference to national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction or any agency of that government, consistent with paragraph (h) of the EDP definition; and (ii) any Crown corporation, agency or any other entity which is wholly-owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities. To be consistent, CMIC further submits that paragraph (g) of the EDP definition should be amended to replace the phrase, "wholly-owned entity of the Government of Canada or a jurisdiction of Canada" with "any other entity which is wholly-owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities".

Exclusion for Clearing Agencies:

In the same vein, CMIC requests that the CSA provide clarification on the scope of the exclusion for clearing agencies contemplated under Section 5 of the Proposed Rules. The wording of Section 5 is similar to Section 6, which simply provides that "this instrument does not apply" to a regulated clearing agency. As discussed above, we have concluded that such wording in Section 6 means that government entities, central banks and international organizations are exempt from complying with the obligations as a derivatives firm under the Proposed Rules, but it does not exempt derivatives firms who face them from the obligations under the Proposed Rules. Accordingly, derivatives firms facing regulated clearing agencies would be required to comply with the obligations under the Proposed Rules, however, regulated clearing agencies are not listed as an EDP. It is possible that they are excluded from the EDP definition because the CSA intends that the *beta* and *gamma* transactions in cleared derivatives (i.e. pursuant to which the original *alpha* transaction between the counterparties is novated to the clearing agency) be excluded from the Proposed Rules, based on the definition of "derivatives dealer" referring to a person engaged in the business of "trading" in derivatives ("trading" is defined[45] to exclude the novation of a derivative with a clearing agency). CMIC believes that such transactions should be excluded given that they are governed by rules and procedures that create a comprehensive framework imposed by clearing agencies, which are therefore not in need of any protection under the Proposed Rules. This should be clarified particularly in light of the above recommendation on page 14 to change the term "trading" to "dealing". Also, clearing agencies enter into proprietary trades that are not cleared transactions. In those circumstances, CMIC believes that clearing agencies should be included within the EDP definition, and thus persons transacting with clearing agencies in uncleared transactions should only be required to comply with the basic obligations that apply to transactions with all counterparties, and should not be required to comply with the more extensive obligations that apply to transactions with unsophisticated counterparties.

Suitability:

CMIC appreciates the importance of suitability obligations in promoting counterparty protection and maintaining a fair and equitable marketplace, but believes that the scope of the suitability obligations contemplated under Section 12 is too wide, particularly insofar as these obligations require that derivatives firms assess suitability in respect of instructions received from counterparties, and not just recommendations made to counterparties. CMIC notes that the requirement to assess suitability in respect of instructions is inconsistent with the suitability requirements under the CFTC rules, which only require swap dealers to assess suitability in respect of recommendations. More specifically, under the CFTC rules, a swap dealer is required to have a reasonable basis for believing that any

[45] See the Ontario Securities Act, s. 1.

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swap or trading strategy that it recommends to a counterparty is suitable for that counterparty[46], but is not required to have a reasonable basis for believing that a particular swap or trading strategy that it has been instructed to enter into is suitable for that counterparty. In addition, under MiFID II[47], suitability obligations are limited to advisory or portfolio management activities, where the investment firm has the obligation to warn the client that the product or service is not appropriate. CMIC submits that it is inappropriate to require derivatives firms to second guess the instructions of their counterparties by performing an additional suitability analysis. CMIC is concerned that such an additional suitability analysis may cause delays in execution and increased costs for counterparties, and may have a negative impact on liquidity in the Canadian derivatives marketplace. Accordingly, CMIC suggests that the requirement to assess suitability in respect of instructions should be eliminated from the Proposed Rules.

CMIC also believes that the suitability obligations under Section 12 are overly broad insofar as these obligations apply to transactions with counterparties who, while not EDPs, nevertheless have demonstrated a level of sophistication, and have made representations that they are capable of independently evaluating a particular derivatives transaction. CMIC notes that under the CFTC rules, a swap dealer will be deemed to satisfy its suitability obligations if, among other things, (i) it determines that the counterparty, or an agent to which the counterparty has delegated decision-making authority, is capable of independently evaluating risks with regard to the relevant swap or trading strategy involving a swap, and (ii) the counterparty or its agent represents in writing that it is exercising independent judgment in evaluating the recommendations of the swap dealer.[48] CMIC is of the view that a similar safe harbour should be included under the Proposed Rules. CMIC submits that the inclusion of such a safe harbour will have the effect of lowering the cost of compliance associated with the suitability obligations contemplated under the Proposed Rules, by reducing the amount of counterparty-specific due diligence that must be undertaken in support of suitability determinations.

CMIC also recommends that an exemption be available from both the information requirement in Section 11 and the suitability requirement in Section 12 for transactions where a counterparty does not know the identity of its counterparty prior to the execution of a transaction. This may arise with block trades, where an adviser transacts on behalf of managed accounts but the dealer does not know which of the adviser's accounts will be allocated to the trade. This may also arise on a venue such as a swap execution facility ("**SEF**") or designated contract market ("**DCM**") where a dealer may not be able to assess suitability due to the anonymous nature of the trade execution.

In addition, CMIC recommends providing relief from suitability requirements to mirror the CFTC's relief in NAL 13-70[49] in respect of swaps that are intended to be cleared ("**ITBC Swaps**"). As rationale for its relief in NAL 13-70, the CFTC noted: (i) the impossibility or impracticality of compliance when the identity of the counterparty is not known prior to execution, (ii) the likelihood that swaps initiated anonymously on a SEF will be standardized and therefore the information about material risks and characteristics of such swaps is likely to be available from the SEF or other wisely available source, (iii) the fact that following clearing, the swap dealer and its counterparty have no further obligations to each other, so there is no on-going relationship that would be governed by trading relationship documentation, and (iv) relief from these requirements provide an incentive to transact on SEFs and to clear swaps, both major policy goals of Dodd-Frank. CMIC submits that this rationale is equally persuasive and relevant in the Canadian context.

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[46] See 17 CFR Part 23, s. 23.434(a).

[47] See MiFID II, a. 25(2) and 25(3).

[48] See 17 CFR Part 23, s. 23.434(b).

[49] CFTC Letter No. 13-70 *No-Action Relief: Swaps Intended to be Cleared* ("**NAL 13-70**"), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-70.pdf.

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Finally, CMIC submits that the suitability obligations under the Proposed Rules should be revised to clarify that suitability is not required to be assessed by a derivatives firm on a transaction-by-transaction basis. In practice, suitability determinations are only made at the time of on-boarding clients and at the time of a material change in circumstances of a client, as it is too burdensome to conduct the due diligence in support of suitability determinations on a transaction-by-transaction basis and may result in delays in processing trades. Accordingly, CMIC believes that derivatives firms should be able to satisfy their suitability obligations by making a suitability determination at the outset of their relationship with a particular derivatives party and thereafter only whenever there has been a material change in circumstances of the derivatives party, and not on a transaction-by-transaction basis. To the extent that suitability determinations may be satisfied by representations from counterparties who are non-EDPs, as CMIC has argued for above, then CMIC anticipates that such representations would be included in relationship documentation that is entered into at the time of on-boarding clients.

Know-your-derivatives party ("**KYDP**"):

CMIC notes that the KYDP information collection requirements under the Proposed Rules are more prescriptive than those under the CFTC rules, and require derivatives firms to collect a variety of KYDP information that may not be required under the CFTC rules. In particular, the Proposed Rules require a derivatives firm to collect information on whether a derivatives party is an insider of a public company or otherwise has access to material non-public information, the identity of any individual who is a beneficial owner of its voting securities (in the case of a corporation) and who exercises control over its affairs (in the case of partnership or trust), which information is not specifically required under the CFTC rules. CMIC notes that it will be operationally burdensome for derivatives firms to begin collecting information from counterparties that they are not already collecting under the CFTC rules. In the interest of reducing compliance costs and promoting efficiency and harmonization, CMIC submits that the CSA should eliminate any KYDP information collection requirements that are inconsistent with the comparable requirements under the CFTC rules, including those identified above.

CMIC also notes that KYDP information collection requirements under the CFTC rules only apply where the identity of a counterparty is known to the swap dealer prior to execution of the transaction, which may be true with respect to derivatives transactions that are executed on a DCM or SEF or in respect of block trades.[50] There is no comparable exemption from the KYDP information collection requirements under the Proposed Rules. Plainly, a derivatives firm will not be able to comply with the KYDP information collection requirements under Sections 10 and 11 of the Proposed Rules in circumstances where it does not know the identity of its counterparty, and accordingly, CMIC requests that the CSA incorporate a comparable exemption into the Proposed Rules.

In addition, CMIC recommends providing relief from KYDP requirements to mirror the CFTC's relief in NAL 13-70 in respect of ITBC Swaps. In addition to the CFTC's rationale discussed above on page 25, we note that dealers typically do not onboard SEF ITBC Swap counterparties due to CFTC guidance that if the swap fails to clear it should be void *ab initio*[51] which mitigates the need for KYDP documentation.

Finally, CMIC acknowledges the inclusion of an exemption[52] from the KYDP information collection requirements for only registered firms and regulated financial institutions. However, CMIC suggests that this exemption be extended to all derivatives firms transacting with or advising EDPs and to derivatives dealers transacting with clients that are not EDPs acting through portfolio managers.

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[50] See 17 CFR Part 23, s. 23.402(b).

[51] CFTC Staff Guidance on Swaps Straight-Through Processing dated September 26, 2013, available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf

[52] See the Proposed Rules, s. 5.

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CMIC expects that the majority of EDPs in the Canadian derivatives marketplace will be large, well established entities, and that information on such entities will be readily available in the public domain. With respect to clients that are not EDPs acting through portfolio managers, derivatives dealers should be able to rely upon the extensive KYDP procedures undertaken by portfolio managers, who will often have a closer relationship with the client.

Conflicts of Interest:

CMIC notes that there is considerable overlap between the conflicts of interest requirements contemplated under the Proposed Rules and the conflicts of interest requirements under existing Canadian laws, including both prudential laws and securities laws. Under the Bank Act[53], for example, Canadian banks are required to establish procedures to identify and address conflicts of interest. More specifically, in the derivatives context, OSFI Guideline B-7 requires federally regulated financial institutions that are dealing in derivatives to take reasonable steps to identify and address potential material conflicts of interest. Although the conflicts of interest requirements under these and other existing Canadian laws may be framed in slightly different terms from those contemplated under the Proposed Rules, CMIC is of the view that they are substantively similar and achieve the same objectives. Since market participants are already subject to conflicts of interest requirements under existing prudential and securities laws, CMIC submits that the conflicts of interest requirements under the Proposed Rules are redundant and unnecessary, and suggests that they be eliminated from the Proposed Rules.

To the extent that the CSA determines that it is necessary to include additional conflicts of interest requirements under the Proposed Rules, CMIC requests that the CSA provide further guidance on the types of conflicts of interest that a derivatives firm would be required to manage under the Proposed Rules, as CMIC believes that the wording of Section 9 and the related commentary in the companion policy is insufficiently precise in identifying such conflicts. In its present form, Section 9 suggests that a derivatives firm may be required to manage a full range of conflicts, both actual and potential, in connection with all of its different business activities. This represents a considerable departure from the conflicts of interest rules under the CFTC rules, where swap dealers are generally only required to manage particular conflicts of interest relating to research and clearing activities. More specifically, the CFTC rules include requirements around the separation of research and clearing units from trading units, and place restrictions on the activities taken within and among these units, but do not otherwise require swap dealers to manage conflicts of interest with respect to other business units.[54] If the CSA determines that it is necessary to include conflicts of interest requirements in the Proposed Rules, then CMIC is of the view that the CSA should harmonize its position with the CFTC, and that these rules should only require derivatives firms to manage conflicts of interest relating to research and clearing activities.

We further submit that an exemption is necessary where the identity of a counterparty is not known to a dealer and where it may not be possible to ascertain certain conflicts of interest that arise in respect of the identity of the counterparty.

Referral Arrangements:

CMIC submits that it is inappropriate to impose broad referral arrangement obligations as contemplated under the Proposed Rules, and notes that there are no comparable obligations under the CFTC rules, other than very limited requirements with respect to referral arrangements involving special entities. Since there are no comparable obligations under the CFTC rules, CMIC expects that foreign derivatives dealers that are complying with the CFTC rules would not be eligible for

[53] *Bank Act* (Canada), S.C. 1991, c. 46 (the "**Bank Act**"), available at: http://laws-lois.justice.gc.ca/eng/acts/B-1.01/.
[54] See 17 CFR Part 23, s. 23.605.

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substituted compliance in respect of these obligations. Without the availability of substituted compliance, CMIC is concerned that many foreign derivatives dealers may be deterred from participating in the Canadian derivatives marketplace, which could have a negative impact on liquidity. Accordingly, CMIC submits that the referral arrangement obligations under the Proposed Rules should be eliminated. At a minimum, it is CMIC`s view that there should be an exception for inter-group referrals.

<u>Complaint Handling</u>:

CMIC believes that derivatives firms are already incentivized to manage (and indeed, do manage) complaints from derivatives parties in an appropriate manner, in order to preserve their relationships with such derivatives parties. In some cases, this may be done by way of a written response, but in other cases, a written response may be unnecessary or inappropriate. As well, CMIC submits that it is inappropriate to include complaint handling obligations under the Proposed Rules, as these obligations are not included in the CFTC rules. Although the CFTC rules do include a requirement for swap dealers to maintain records of complaints[55], they do not otherwise include any requirements around how complaints are to be handled. Accordingly, CMIC does not believe that an obligation to handle complaints in any particular manner should be codified in the Proposed Rules. As noted above, if the CSA includes such an obligation in the Proposed Rules, CMIC expects that foreign derivatives dealers would not be entitled to substituted compliance in respect of such obligation, which may be an additional reason that could deter foreign derivatives dealers from participating in the Canadian derivatives marketplace.

<u>Tied Selling</u>:

The tied selling rules are duplicative of existing rules found in Canadian legislation. For example, there are provisions under the Bank Act[56] which provide that a bank may not impose undue pressure on, or coerce, a person to obtain a product or service from a particular person as a condition for obtaining another product or service from the bank. Similarly, the *Unfair or Deceptive Acts or Practices Regulation* under the *Insurance Act* (Ontario) provides that no person shall engage in any unfair or deceptive act or practice, which is defined to include making the issuance or variation of a policy of automobile insurance conditional on the insured having or purchasing another insurance policy. CMIC also believes that it is inappropriate to impose a prohibition on tied selling under the Proposed Rules, which again, does not have an analogue under the CFTC rules nor under MiFID II. Accordingly, since there are existing regulations dealing with tied selling, along with the fact that there are no tied selling provisions under the CFTC rules nor MiFID II, CMIC submits that the tied selling provisions should be deleted from the Proposed Rules.

<u>Disclosure to Derivatives Parties</u>:

CMIC appreciates the importance of disclosure obligations in increasing transparency and reducing the informational asymmetries between derivatives firms and derivatives parties. As noted at the outset of this letter, however, CMIC believes that the disclosure requirements under the Proposed Rules should be harmonized with the disclosure requirements under the CFTC rules to the greatest degree possible, as it will be operationally burdensome and costly for derivatives dealers to begin implementing new disclosure processes that have not already been implemented in connection with the CFTC rules.

With that principle in mind, CMIC notes that there are several mandatory disclosure requirements contemplated under the Proposed Rules that are inconsistent with the mandatory disclosure

[55] See 17 CFR Part 23, s. 23.201(b).

[56] See the Bank Act, s. 459.1.

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requirements under the CFTC rules. By way of example, CMIC notes that the following disclosure obligations do not appear to have an analogue under the CFTC rules: (i) the obligation to disclose the risks of using borrowed money or leverage in a written statement delivered to a derivatives party prior to a transaction, (ii) the obligation for a foreign derivatives dealer to provide a notice to a derivatives party of the legal risks of dealing with a party located in a foreign jurisdiction, and (iii) the obligation for a derivatives firm to provide general relationship information including, for example, information on its business and products, information on the compensation paid to its employees, and information on any conflicts of interest that may exist between the derivatives firm and the derivatives party. With respect to each of these items, CMIC has not been able to identify comparable disclosure obligations under the CFTC rules. Derivatives firms would therefore be required to implement new disclosure processes in order to comply with these additional disclosure obligations. CMIC submits that the benefits provided by these particular disclosure obligations would be outweighed by the costs of implementing these disclosure obligations, and accordingly, suggests that they be removed from the Proposed Rules.

With respect to pre-transaction disclosure, CMIC recognizes that the pre-transaction disclosure requirements under the Proposed Rules, which require a derivatives firm to disclose information about the material characteristics and risks of a derivatives transaction, are largely consistent with the pre-transaction disclosure requirements under the CFTC rules. However, CMIC notes that under the CFTC rules, there is an exemption from the pre-transaction disclosure requirements for transactions that are executed on a SEF or a DCM, and where it is impossible to determine the identity of the counterparty prior to the transaction.[57] There are no comparable exemptions included under the Proposed Rules. As a result, derivatives firms may be placed in the untenable position of being required to disclose certain transactional information to a derivatives party whose identity is unknown to the derivatives firm at the time of entering into the transaction. As this is clearly an unworkable standard, CMIC requests that the CSA incorporate exemptions from the pre-transaction disclosure obligations that parallel those exemptions that are included under the CFTC rules. In addition, CMIC recommends providing relief from disclosure requirements to mirror the CFTC's relief in NAL 13-70 in respect of ITBC Swaps.

<u>Notice by Non-resident Derivatives Firms</u>

As noted previously under the last paragraph of the Substituted Compliance discussion on page 8, it is CMIC`s view that the notice requirement for non-resident derivatives firms under Section 23 is not necessary and should be deleted. CMIC submits that the information that is required to be provided under Section 20 would sufficiently cover the information set out under Section 23 since Section 20 requires that a derivatives firm must deliver all information that a reasonable person would consider important. Further, with respect to the name and address of the agent for services, this is standard information provided in relationship documentation.[58]

<u>Reporting to Derivatives Parties</u>:

As noted above, CMIC appreciates the importance of reporting obligations in increasing transparency and reducing informational asymmetries, but believes that it is necessary to harmonize the reporting requirements under the Proposed Rules with those under the CFTC rules wherever possible, in order to increase efficiencies and reduce costs.

Valuations

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[57] See 17 CFR Part 23, s. 23.431(c).

[58] See Part 4 of the standard Schedule to an ISDA master agreement.

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With respect to the requirement to provide valuations, CMIC notes that both the Proposed Rules and the CFTC rules require a dealer to provide a counterparty with a daily mark, but the Proposed Rules require a daily mark be provided in a broader range of transactions. In particular, the Proposed Rules appear to contemplate that derivatives firms will make available daily marks for both cleared and uncleared transactions, whereas the CFTC rules only require swap dealers to provide daily marks for uncleared transactions.[59] This is a substantial difference. CMIC notes that for transactions that are cleared through a clearing agency, derivatives parties will already have access to valuation information from the clearing agency. As such, CMIC submits that the requirement for a derivatives firm to make additional valuation information available to a derivatives party is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by any attendant benefits. Accordingly, CMIC is of the view that the requirement for derivatives firms to make available daily marks under the Proposed Rules should be harmonized with the requirement for swap dealers to make available daily mid-market marks under the CFTC rules, and that daily marks should only be required for uncleared transactions. In addition, CMIC submits that the Proposed Rules should allow counterparties to be given the option of not being provided with this daily valuation as it may be the case that certain counterparties are not interested in receiving that information. In such circumstances, the derivatives firm should not be required to make that information available to those counterparties.

Trade Confirmations

Similarly, although both the Proposed Rules and the CFTC rules require a dealer to provide a counterparty with a post-trade confirmation, there are differences in the content of the trade confirmations under these two regimes by virtue of their level of prescription. The Proposed Rules include a number of requirements for the content of trade confirmations that are not included in the CFTC rules. For example, the Proposed Rules require trade confirmations to include information on the nature of the derivatives dealer's involvement in the transaction (i.e. whether it is transacting as principal or agent), the commissions or sales charges levied by the derivatives firm, and the name of the individual acting on behalf of the derivatives firm, none of which are identified as necessary contents under the CFTC rules. CMIC notes that to the extent that derivatives dealers are required to include information in trade confirmations that are delivered pursuant to the Proposed Rules that is not required to be included in trade confirmations that are delivered pursuant to the CFTC rules, then derivatives dealers may be required to prepare different trade confirmations for different jurisdictions, and may need to engage in the costly exercise of re-configuring their reporting systems to account for these differences. Moreover, although CMIC expects that many of the prescribed contents under the Proposed Rules would generally be included in trade confirmations, there may be circumstances where it does not make sense for a derivatives firm to include this type of information in a particular trade confirmation, for example, because of the nature of the asset that is being transacted. Accordingly, CMIC believes that the CSA should be less prescriptive with respect to the contents of trade confirmations, and should not specify any particular required contents.

Transactions executed on derivatives trading facilities; cleared transactions

As well as differences in the content of trade confirmations under the Proposed Rules and the CFTC rules, there are also differences in the availability thereof, as a result of exemptions from the trade confirmation requirements under the CFTC rules. That is, under the CFTC rules, swap dealers are not required to deliver trade confirmations for transactions that are executed on a SEF or DCM and for transactions that are submitted for clearing by a DCO, as such transaction confirmations will be separately prepared and delivered by the SEF, DCM or DCO, as applicable.[60] There is no comparable exemption under the Proposed Rules. In the absence of such an exemption, derivatives

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[59] See 17 CFR Part 23, s. 23.431(d).

[60] See 17 CFR Part 23, s. 23.501(a)(4).

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dealers will be required to prepare and deliver transaction confirmations to derivatives parties, notwithstanding that derivatives parties will already be receiving such transaction confirmations from a derivatives trading facility or a clearing agency and that the derivatives dealer may not know the identity of its counterparty. As with the requirement to provide a daily mark for cleared swaps, CMIC submits that this requirement is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by any potential benefits that may result from having a second transaction confirmation. Accordingly, CMIC submits that the Proposed Rules should be revised to include an exemption from the requirement to deliver trade confirmations for transactions that are executed on a derivatives trading facility or for transactions that are submitted for clearing.

Monthly Statements

In addition to daily marks and trade confirmations, the Proposed Rules also contemplate that derivatives firms will provide derivatives parties with monthly statements addressing, among other things, recent derivatives transactions, current derivatives positions, a description of derivatives party assets held by the derivatives firm and account balances. CMIC notes that there is no comparable requirement to provide monthly statements under the CFTC rules. In addition, CMIC notes that while there is a requirement to provide periodic reports under MiFID II, these periodic reports are only provided on a quarterly basis, and moreover, are only delivered where an investment firm is providing portfolio management services.[61] As there are no requirements to prepare monthly statements under either the CFTC rules or MiFID II, it will be necessary for derivatives dealers to implement new reporting technology to facilitate the preparation and delivery of the monthly statements contemplated under the Proposed Rules. This will be operationally burdensome and costly for derivatives dealers. Moreover, CMIC anticipates that many derivatives parties do not wish to receive monthly statements. Accordingly, CMIC is of the view that the requirement for derivatives firms to deliver monthly statements should be eliminated.

Record-keeping:

CMIC notes that the CSA has already introduced extensive record-keeping requirements under MI 96-101[62] and the equivalent regulations in the Provinces of Manitoba, Ontario and Quebec (collectively, the "**TR Rule**"). CMIC submits that the requirement for derivatives firms to maintain records under the Proposed Rules that are comparable to those maintained under the TR Rule is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by identified benefits. Accordingly, CMIC submits that the record-keeping requirements under the Proposed Rules should be eliminated, and that derivatives firms should only be subject to record-keeping requirements in accordance with the TR Rule.

In the context of derivatives firms that are federally regulated financial institutions, CMIC notes that the record-keeping requirements under the Proposed Rules are also duplicative of record keeping requirements under prudential regulations. For example, under the RCM Guideline, OSFI expects a federally regulated financial institution's regulatory compliance management framework to include ''Adequate Documentation'' as one of its key controls. Likewise, pursuant to OSFI Guideline B-7, each federally regulated financial institution is required to have mechanisms in place to assure the confirmation, maintenance, and safeguarding of derivatives contract documentation. As noted above, CMIC believes that the record-keeping requirements under the Proposed Rules are redundant and should be eliminated in their entirety. However, if the CSA believes that additional record-keeping requirements in the Proposed Rules are necessary, then CMIC submits that federally regulated

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[61] See the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, a. 60(1).

[62] Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* ("**MI 96-101**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/96-101__MI___July_28__2016/.

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financial institutions should be exempt from compliance with such record-keeping requirements, similar to the exemption for compliance with the KYDP information collection requirements (which are similarly covered under existing Canadian laws and regulations). In the alternative, CMIC believes that federally regulated financial institutions should be granted substituted compliance with respect to the record-keeping requirements, pursuant to Section 42 of the Proposed Rules.

With respect to the written agreement requirement under Section 35 of the Proposed Rules, CMIC notes that both the Proposed Rules and the CFTC rules require derivatives firms to enter into written agreements with derivatives parties detailing the material terms of their relationships and describing their respective rights and obligations. CMIC acknowledges that the prescribed contents of these written agreements, which includes payment terms, netting terms, event of default terms, valuation terms and dispute resolution terms, are substantively similar under both the Proposed Rules and the CFTC rules. However, CMIC is concerned that the written agreement obligations under the Proposed Rules may be broader than those under the CFTC rules, insofar as they require derivatives parties to enter into written agreements for certain transactions that would not require a written agreement under the CFTC rules. In particular, the CFTC rules include an exemption from the written agreement requirement for transactions that are executed on a DCM or anonymously on a SEF, and for transactions that are cleared by a DCO.[63] There are no comparable exemptions for these transactions under the Proposed Rules. As noted above, it is obvious that a derivatives firm will not be able to enter into a written agreement with a derivatives party whose identity is unknown to the derivatives firm, and accordingly, CMIC submits that a comparable exemption should be included under NI 93-101.

Similarly, under the CFTC rules, swap dealers may satisfy the written agreement requirement in respect of certain FX transactions by way of a deemed ISDA pursuant to the DF Protocol. CMIC notes that it is unlikely that derivatives firms in Canada will be able to enter into a comparable protocol providing for deemed ISDAs, in light of the small size of the Canadian derivatives market. As a result, derivatives firms may be required to enter into written agreements when engaging in FX transactions in Canada, but may not be required to enter into such agreements when engaging in FX transactions in the U.S. In order to avoid this regulatory gap, CMIC believes that it would be appropriate for the CSA to include an exemption from the written agreement requirement for FX transactions, which would align with current market practice. As noted at the outset of this letter, FX markets are mature and transparent, and because foreign exchange products are frequently used as hedging products, it may be less important for derivatives firms and derivatives parties to enter into written agreements in connection with such transactions.

CMIC submits that the use of both the terms “derivatives” and “transactions” under the recordkeeping requirement in Section 36 is confusing. The term, “transaction” is defined as being limited to derivatives. Therefore, CMIC recommends that the following changes should be made to Section 36:

- the phrase “derivatives, transactions” in the lead-in language of Section 36 should be amended to remove the comma that appears between the two words; and

- the phrase “for each derivative” that appears at the beginning of Sections 36(b) and (c) should be replaced with “for each transaction”.

Further, CMIC submits that Sections 36(d)(vii) and (viii) should be deleted as these items relate to systemic risk and not business conduct. Recordkeeping in respect of netting of derivatives and margining and collateralization is already addressed under applicable margin rules.

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[63] See 17 CFR Part 23, s. 23.504(a)(ii).

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CMIC notes that Section 37 of the Proposed Rules provides that a derivatives firm must keep a record for a period of 7 years following the date on which the derivatives party`s last derivative expires or is terminated, except in the case of Manitoba, which requires this period be 8 years. CMIC submits that this time period should be harmonized amongst all jurisdictions in Canada.

End-user Exemption:

CMIC requests that the CSA revise the end-user exemption under Section 39 to clarify the scope of this exemption. CMIC notes that as presently drafted, the concept of an end-user is essentially framed in opposite terms from the concept of a derivatives firm. CMIC submits that this formulation of the concept of an end-user is vague and imprecise. Rather, CMIC is of the view that end-users should be defined by reference to particular categories of persons that should be considered end-users. Under the MiFID II regime, for example, CMIC notes that certain categories of persons, including pension funds, insurance and reinsurance companies and collective investment undertakings, are excluded from the scope of the business conduct rules under MiFID II.[64] CMIC believes that a comparable approach should be adopted under the Proposed Rules, and that all of these categories of persons should be exempt from the business conduct obligations under the Proposed Rules, on the basis that these categories of persons are end-users and are not commercial providers of derivatives products.

Effective Date:

CMIC submits that the effective date of the Proposed Rules should incorporate a one year transition period, commencing on the date the Proposed Rules come into force. This will allow derivatives firms sufficient time to implement any procedural and systems changes, including conducting a client outreach, before they are required to comply with the final rules.

CONCLUSION

As you will have seen, CMIC has provided its comments and recommendations on the Proposed Rules within the four themes of (i) duplication of the Proposed Rules (for example, fair dealing, KYDP and substituted compliance recommendations), (ii) harmonization with global rules (for example, suitability, referral obligations and tied selling recommendations), (iii) fundamental differences between the OTC derivatives markets and securities markets (for example, inter-dealer exemption, FX Transaction exemption, derivatives party assets and fair terms and pricing recommendations) and (iv) the timing of implementation (effective date recommendation). CMIC also re-iterates its very strong recommendation that a second, full comment period be afforded to market participants on the Proposed Rules, concurrently with a second, full comment period on Registration Rules so that they can both be analyzed together in order to determine their full effect on market participants and the Canadian OTC derivatives markets.

CMIC welcomes the opportunity to discuss this response with you. The views expressed in this letter are the views of the following members of CMIC:

Alberta Investment Management Corporation
Bank of America Merrill Lynch
Bank of Montreal
Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce

[64] See MiFID II, a. 2(1).

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Citigroup Global Markets Inc.
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Invesco Canada Ltd.
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
Morgan Stanley
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Public Sector Pension Investment Board
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank

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SCHEDULE A TO
CMIC RESPONSE LETTER TO PROPOSED NI 93-101
(see attached)

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APPENDIX A
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

FOREIGN DERIVATIVES DEALERS
(Section 40)

LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO FOREIGN DERIVATIVES DEALERS

Foreign Jurisdiction	Laws, Regulations or Instruments	Provisions of this Instrument applicable to a foreign derivatives dealer despite compliance with the foreign jurisdiction's laws, regulations or instruments
United States	Section 24.433 of Code of Federal Regulations, Title 17, Part 23 *Swap Dealers and Major Swap Participants* ("**17 CFR Part 23**") – Communications – fair dealing Section 23.410 of 17 CFR Part 23 – Prohibition on fraud, manipulation, and other abusive practices	Section 8 – Fair dealing
United States	Section 23.605 of 17 CFR Part 23 – Conflicts of interest policies and procedures	Section 9 – Conflicts of interest
United States	Section 23.402 of 17 CFR Part 23 – General provisions	Section 10 – Know your derivatives party
United States	Section 23.434 of 17 CFR Part 23 – Recommendations to counterparties – institutional suitability	Section 11 – Derivatives-party-specific needs and objectives Section 12 – Suitability
United States	Section 23.504 of 17 CFR Part 23 – Swap trading relationship documentation	Section 20 – Relationship disclosure information
United States	Section 23.321 of 17 CFR Part 23 – Disclosures of material information	Section 21 – Pre-transaction disclosure
United States	Section 23.321(d) of 17 CFR Part 23 – Disclosures of material information – Daily mark	Section 22 – Daily reporting
United States	Section 23.701 of 17 CFR Part 23 –	Section 25 – Segregating derivatives

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	Notification of right to segregation Section 23.702 of 17 CFR Part 23 – Requirements for segregated margin Section 23.704 of 17 CFR Part 23 Investment of segregated margin Section 23.704 of 17 CFR Part 23 Requirements for non-segregated margin	party assets Section 26 – Holding derivatives party assets Section 27 – Use of derivatives party assets Section 28 – Investment of derivatives party assets
United States	Section 23.501 of 17 CFR Part 23 – Swap confirmation	Section 29 – Content and delivery of transaction confirmations
United States	Section 23.201 of 17 CFR Part 23 – Required records Section 23.202 of 17 CFR Part 23 – Daily trading records Section 23.203 of 17 CFR Part 23 – Records; retention and inspection	Section 36 – Records Section 37 – Form, accessibility and retention of records
European Union	Article 24 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 (the "**MiFID II Directive**") – General principles and information to clients Article 28 of MiFID II Directive – Client order handling rules	Section 8 – Fair dealing
European Union	Article 16 of MiFID II Directive – Organisational requirements Article 23 of MiFID II Directive – Conflicts of interest Article 33 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 (the "**MiFID II Delegated Regulation**") – Conflicts of interest potentially detrimental to a client Article 34 of MiFID II Delegated Regulation – Conflicts of interest policy Article 35 of MiFID II Delegated	Section 9 – Conflicts of interest

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	Regulation – Record of services or activities giving rise to a detrimental conflict of interest Article 36 of MiFID II Delegated Regulation – Investment research and marketing communications Article 37 of MiFID II Delegated Regulation – Additional organisational requirements in relation to investment research or marketing communications Article 38 of MiFID II Delegated Regulation – Additional general requirements in relation to underwriting or placing Article 39 of MiFID II Delegated Regulation – Additional requirements in relation to pricing of offerings in relation to issuance of financial instruments Article 40 of MiFID II Delegated Regulation – Additional requirements in relation to placing Article 41 of MiFID II Delegated Regulation – Additional requirements in relation to advice, distribution and self placement Article 42 of MiFID II Delegated Regulation – Additional requirements in relation to lending or provision of credit in the context of underwriting or placement Article 43 of MiFID II Delegated Regulation – Record keeping in relation to underwriting or placing	
European Union	Article 25 of MiFID II Directive – Assessment of suitability and appropriateness and reporting to clients Article 54 of MiFID II Delegated Regulation – Assessment of suitability	Section 11 – Derivatives-party-specific needs and objectives Section 12 – Suitability

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	and suitability reports Article 55 of MiFID II Delegated Regulation – Provisions common to the assessment of suitability and appropriateness Article 56 of MiFID II Delegated Regulation – Assessment of appropriateness and related record-keeping obligations	
European Union	Article 24 of MiFID II Directive – General principles and information to clients Article 11 of Commission Delegated Directive (EU) 2017/593 of 7 April 2016 (the "**MiFID II Delegated Directive**") Article 12 of MiFID II Delegated Directive – Inducements in respect of investment advice on an independent basis or portfolio management services Article 13 of MiFID II Delegated Directive – Inducements in relation to research	Section 13 – Permitted referral arrangements Section 14 – Verifying the qualifications of the person or company receiving the referral Section 15 – Disclosing referral arrangements to a derivatives party
European Union	Article 26 of MiFID II Delegated Regulation – Complaints handling	Section 17 – Handling complaints
European Union	Article 27 of MiFID II Directive – Obligation to execute orders on terms most favourable to the client Article 64 of MiFID II Delegated Regulation – Best execution criteria Article 65 of MiFID II Delegated Regulation – Duty of investment firms carrying out portfolio management and reception and transmission of orders to act in the best interests of the client Article 66 of MiFID II Delegated Regulation – Execution policy	Section 19 – Fair terms and pricing

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European Union	Article 25 of MiFID II Directive – Assessment of suitability and appropriateness and reporting to clients Article 58 of MiFID II Delegated Regulation – Retail and Professional Client agreements	Section 20 – Relationship disclosure information
European Union	Article 48 of MiFID II Delegated Regulation – Information about financial instruments	Section 21 – Pre-transaction disclosure
European Union	Article 9 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 (“**EMIR**”)	Section 22 – Daily reporting
European Union	Article 16 of MiFID II Directive – Organisational requirements Article 2 of MiFID II Delegated Directive – Safeguarding of client financial instruments and funds Article 3 of MiFID II Delegated Directive – Depositing of client financial instruments Article 4 of MiFID II Delegated Directive – Depositing client funds Article 5 of MiFID II Delegated Directive – Use of client financial instruments Article 6 of MiFID II Delegated Directive – Inappropriate use of title transfer collateral arrangements Article 7 of MiFID II Delegated Directive – Governance arrangements concerning the safeguarding of client assets Article 8 of MiFID II Delegated Directive – Reports by external auditors	Section 25 – Segregating derivatives party assets Section 26 – Holding derivatives party assets Section 27 – Use of derivatives party assets Section 28 – Investment of derivatives party assets
European Union	Article 59 of MiFID II Delegated Regulation – Reporting obligations in	Section 29 – Content and delivery of

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	respect of execution of orders other than for portfolio management	transaction confirmations
European Union	Article 16 of MiFID II Directive – Organisational requirements Article 72 of MiFID II Delegated Regulation – Retention of records Article 73 of MiFID II Delegated Regulation – Record keeping of rights and obligations of the investment firm and the client Article 74 of MiFID II Delegated Regulation – Record keeping of client orders and decision to deal Article 75 of MiFID II Delegated Regulation – Record keeping of transactions and order processing Article 76 of MiFID II Delegated Regulation – Recording of telephone conversations or electronic communications	Section 36 – Records Section 37 – Form, accessibility and retention of records

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SCHEDULE B TO
CMIC RESPONSE LETTER TO PROPOSED NI 93-101
(see attached)

INCLUDES COMMENT LETTERS

APPENDIX C
TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT*

CANADIAN FINANCIAL INSTITUTIONS
(Section 42)

LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO CANADIAN FINANCIAL INSTITUTIONS

Federal or provincial prudential regulator or other applicable regulator	**Laws, Regulations or Instruments**	**Provisions of this Instrument applicable to a Canadian Financial Institution despite compliance with applicable federal or provincial regulatory requirements**	**Commentary**
Office of the Superintendent of Financial Institutions (“OSFI”)/ Securities commissions/ Competition Bureau	OSFI Guideline B-7 *Derivatives Sound Practices* *Securities Act* (Ontario), s. 126.1, 127 *Bhasin v. Hrynew*, 2014 SCC 71 *Competition Act,* Part VII.1	Fair Dealing – s. 8(1), 8(2), 8(3)	OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a federally regulated financial institution (“**FRFI**”) should act honestly and in good faith when marketing, negotiating, entering into, executing and administering transactions with its clients or counterparties. Staff who are involved in trading or providing advice in relation to derivatives trades should have the appropriate education, skills, experience and training to carry out their responsibilities. Ontario securities regulators also have broad public interest powers under Section 127 of the Ontario *Securities Act* (the “OSA”). In addition, separate from the public interest powers, the OSA also deals with fraud and with misleading or untrue statements. More generally, the Supreme Court of Canada in *Bhasin v. Hrynew* recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result

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			of *Bhasin*, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest performance, which cannot be excluded by the terms of an agreement. These obligations apply only to the corporate counterparty, because of privity of contract, and not to individuals acting on behalf of the corporate counterparty. The exception to this would be an independent tort that would arise if the individual acted fraudulently. In addition, certain deceptive marketing practices are criminal offences or reviewable matters under the *Competition Act*, including false and misleading representations to the public (which can include misrepresentations to businesses).
OSFI	*Bank Act,* s. 157(2)(b), 157(2)(c), 459.1(1), 459.1(4.1) *Insurance Companies Act,* s. 165(2)(b), 165(2)(c), 489 OSFI *Supervisory Framework* OSFI Guideline B-7 *Derivatives Sound Practices*	Conflicts of interest – s. 9(1), 9(2), 9(3)	Pursuant to Section 157(2)(c) of the *Bank Act*, the directors of the bank must establish procedures to resolve conflicts of interest, including techniques for the identification of potential conflict situations and for restricting the use of confidential information. Pursuant to Section 157(2)(b) of the Bank, the directors of a bank must establish a review committee to ensure compliance with the self-dealing provisions of the *Bank Act*, while 157(2)(d) requires that banks designate a committee of the board of directors to monitor the conflict of interest procedures. Section 459.1(1) of the *Bank Act* prohibits a bank from imposing undue pressure on, or coercing a person to obtain a product or service from a particular person, including the bank and any of its affiliates, as a condition for obtaining another product or

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			service from the bank. Section 459.1(4.1) requires a bank to disclose coercive tied selling arrangements. Equivalent requirements apply to federally regulated insurance companies (s. 165(2)(b), 165(2)(c), 489 *Insurance Companies Act*) under the equivalent legislation. In addition, OSFI's *Supervisory Framework* requires monitoring of conflicts of interest through a bank's risk management program. More specifically, in the derivatives context, OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a FRFI dealing in derivatives should take reasonable steps to identify and address potential material conflicts of interest.
OSFI/ Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC")	*Proceeds of Crime (Money Laundering) Terrorist Financing Act* and associated regulations FINTRAC guidelines OSFI Guideline B-8 *Deterring and Detecting Money Laundering and Terrorist Financing*	Know your client (KYC) – s. 10(2), 10(3), 10(4), 10(5)	The *Proceeds of Crime (Money Laundering) Terrorist Financing Act* and associated regulations and guidelines as well as OSFI Guideline B-8 *Deterring and Detecting Money Laundering and Terrorist Financing* have extensive requirements relating to KYC and in particular require FRFIs to establish an anti-money laundering program, including written policies and procedures, and to identify the identity of its clients. In particular, in the case of a client that is an entity, FRFIs must in particular take reasonable measures to obtain the names, addresses and occupations of individuals who are the ultimate beneficial owners of 25% or more of the entity.
OSFI	OSFI Guideline B-7 *Derivatives Sound Practices*	Suitability – s. 11, 12(1), 12(2)	OSFI Guideline B-7 *Derivatives Sound Practices*, provides that FRFIs are expected to take necessary steps to mitigate legal

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			risk, including, prior to engaging in derivatives transactions.
N/A	*Criminal Code* s. 426	Referrals – s. 13, 14, 15(1)	Pursuant to Section 426 of the *Criminal Code*, it is an offence to (a) directly or indirectly, corruptly gives, offers or agrees to give or offer to an agent or to anyone for the benefit of the agent — or, being an agent, directly or indirectly, corruptly demands, accepts or offers or agrees to accept from any person, for themselves or another person — any reward, advantage or benefit of any kind as consideration for doing or not doing, or for having done or not done, any act relating to the affairs or business of the agent's principal, or for showing or not showing favour or disfavour to any person with relation to the affairs or business of the agent's principal; or (b) with intent to deceive a principal, gives to an agent of that principal, or, being an agent, uses with intent to deceive his principal, a receipt, an account or other writing (i) in which the principal has an interest, (ii) that contains any statement that is false or erroneous or defective in any material particular, and (iii) that is intended to mislead the principal.
OSFI/ Financial Consumer Agency of Canada ("FCAC")	*Bank Act*, s. 455 *Insurance Companies A*ct, s. 486 *Complaints (Banks, Authorized Foreign Banks and External Complaint Bodies) Regulations* FCAC Guidance CG-12 *Internal dispute resolution*	Complaints handling – s. 17(1)	Pursuant to Section 455 of the *Bank Act*, a bank must (a) establish procedures for dealing with complaints made by persons having requested or received products or services in Canada from a bank, (b) designate an officer or employee of the bank to be responsible for implementing those procedures; and (c) designate one or more officers or employees of the bank to receive and deal with those complaints. In addition, pursuant to the *Complaints (Banks, Authorized Foreign Banks and External Complaint Bodies)*

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			Regulations, banks must report to the public the number of complaints received, the average length of time to deal with complaints and the number of complaints resolved satisfactorily. Equivalent requirements apply to Section 455 of the *Bank Act* apply to federally regulated insurance companies (s. 486 *Insurance Companies Act*). In addition, the Financial Consumer Agency of Canada (which has jurisdiction over banks and federal trust companies but not federally regulated insurance companies) has issued Guidance CG-12 *Internal dispute resolution* which provides further guidance on the requirements in respect of such policies and procedures.
OSFI/ Competition Bureau	*Bank Act*, s. 459.1 *Competition Act*, s. 77	Tied selling – s. 18(1), 18(2)	Section 459.1 of the *Bank Act* provides that a bank may not impose undue pressure on, or coerce, a person to obtain a product or service from a particular person, including the bank and any of its affiliates, as a condition for obtaining another product or service from the bank. In addition, the bank must disclose the prohibition on coercive tied selling in a statement in plain language that is clear and concise, displayed and available to customers and the public at all of its branches where products or services are offered in Canada, on all of its websites through which products or services are offered in Canada and at all prescribed points of service in Canada. Section 77 of the *Competition Act* provides that where the Competition Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely

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			to (a) impede entry into or expansion of a firm in a market, (b) impede introduction of a product into or expansion of sales of a product in a market, or (c) have any other exclusionary effect in a market, with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market.
OSFI	OSFI Guideline B-7 *Derivatives Sound Practices* *Securities Act* (Ontario), s. 126.1, 127 *Bhasin v. Hrynew*, 2014 SCC 71 *Competition Act,* Part VII.1	Fair terms – s. 19(1), 19(2)	OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a FRFI should act honestly and in good faith when marketing, negotiating, entering into, executing and administering transactions with its clients or counterparties. Staff who are involved in trading or providing advice in relation to derivatives trades should have the appropriate education, skills, experience and training to carry out their responsibilities. Ontario securities regulators also have broad public interest powers under Section 127 of the OSA. In addition, separate from the public interest powers, the OSA also deals with fraud and with misleading or untrue statements. More generally, the Supreme Court of Canada in *Bhasin v. Hrynew* recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result of *Bhasin*, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest

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			performance, which cannot be excluded by the terms of an agreement. These obligations apply only to the corporate counterparty, because of privity of contract, and not to individuals acting on behalf of the corporate counterparty. The exception to this would be an independent tort that would arise if the individual acted fraudulently. In addition, certain deceptive marketing practices are criminal offences or reviewable matters under the *Competition Act*, including false and misleading representations to the public (which can include misrepresentations to businesses).
OSFI/ Securities commissions	NI 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*	Safeguarding of counterparty assets – s. 25, 26, 27(1), 27(2), 27(3), 28(1), 28(2), 28(3)	NI 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* requires segregation of assets. OSFI Guideline E-22 *Margin Requirements for Non-Centrally Cleared Derivatives* establishes minimum standards for margin requirements for non-centrally cleared derivative transactions undertaken by FRFIs. Assets delivered for initial margin must be segregated and no re-hypothecation is allowed. Assets delivered for variation margin are not required to be segregated and it can be implied that re-hypothecation would be allowed.
OSFI	OSFI Guideline B-7 *Derivatives Sound Practices* OSFI Guideline D-6 *Derivatives Disclosure*	Mandatory disclosure to counterparties – s. 35(1), 35(2), 20(1), 20(2), 20(3)	OSFI Guideline B-7 *Derivatives Sound Practices* states that FRFIs should seek to agree in writing with counterparties to all material terms governing their trading relationship prior to or at the time of execution of a non-centrally cleared derivative. In addition, OSFI Guideline D-6 *Derivatives Disclosure*

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			supplements guidance set forth in IFRS 7 which provides disclosure requirements for financial instruments. The Guideline addresses disclosure in the FRFI's annual report and OSFI annual returns, in particular with respect to notional amounts, other derivatives disclosure and positive replacement cost, credit equivalent amount and risk-weighted equivalent.
OSFI	OSFI Guideline B-7 *Derivatives Sound Practices*	Reporting to counterparties – s. 22, 29(1), 29(2), 29(3), 29(4), 30(1), 30(2), 30(3)	OSFI Guideline B-7 *Derivatives Sound Practices* provides that a FRFI should establish and implement processes and procedures that allow it to confirm the material terms of bilateral derivatives transactions in a timely manner after execution to reduce the potential for losses from market risk or other sources. Where practicable based on the nature, size and complexity of the FRFI and its derivatives activities, electronic methods and standard settlement instructions should be used to maximize the use of straight through processing (STP) and allow for prompt confirmation and affirmation. In addition, OSFI expects that a FRFI report derivatives transactions to a recognized trade repository, following the derivatives data reporting requirements that have been adopted in the province in which the head office and/or principal place of business of the FRFI is located ("local reporting requirements").
OSFI	*Bank Act*, s. 238, 239, 597 *Insurance Companies Act*, s. 261, 262, 647 OSFI *Supervisory Framework* OSFI Guideline B-7 *Derivatives Sound*	Record-keeping – s. 36	Sections 238, 239 and 597 of the *Bank Act* generally require banks carrying on business in Canada to maintain records in Canada and to ensure that OSFI can access in Canada any records necessary to enable OSFI to fulfill its supervisory mandate. In particular, pursuant to Section 238 of the *Bank Act*, a bank must prepare and maintain records

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	Practices		containing the following (a) the incorporating instrument and the by-laws of the bank, (b) minutes of meetings and resolutions of shareholders and members, (c) the names of directors and auditors, (d) particulars of any authorizations, conditions and limitations established by OSFI in respect of the commencement and carrying on of business of the bank that are from time to time applicable to the bank, (e) particulars of exceptions granted in respect of any discontinuance, permission to a subsidiary of a foreign bank, or a sale of all or substantially all of its assets that are from time to time applicable to the bank; and (f) particulars from Schedule I or II that are applicable to the bank as they are from time to time amended and published in the Canada Gazette. In addition, a bank must prepare and maintain adequate (a) corporate accounting records, (b) records containing minutes of meetings and resolutions of the directors and any committee thereof; and (c) records showing, for each customer of the bank, on a daily basis, particulars of the transactions between the bank and that customer and the balance owing to or by the bank in respect of that customer. Equivalent requirements apply to federally regulated insurance companies (s. 261, 262, 647 *Insurance Companies Act*) under the equivalent legislation. In addition, OSFI's *Supervisory Framework* requires FRFIs to establish and maintain an enterprise-wide RCM framework of regulatory risk management controls, and these controls include oversight functions that are independent of the activities

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			they oversee. OSFI expects the RCM framework to include ''Adequate Documentation'' as one of its key controls. As set forth in OSFI Guideline B-7 *Derivatives Sound Practices*, each FRFI should have mechanisms in place to assure the confirmation, maintenance, and safeguarding of derivatives contract documentation. In particular, it states: "A FRFI should establish and implement processes and procedures that allow it to confirm the material terms of bilateral derivatives transactions in a timely manner after execution to reduce the potential for losses from market risk or other sources."
OSFI	*Bank Act*, s. 157, 465 *Insurance Companies Act*, s. 492, 615 OSFI Guideline E-13 *Regulatory Compliance Management* OSFI Guideline B-7 *Derivatives Sound Practices* OSFI Guideline B-1 *Prudent Person Approach* OSFI Guideline B-2 *Large Exposure Limits* OSFI *Corporate Governance Guideline*	Compliance and risk management – s. 32	OSFI Guideline E-13 *Regulatory Compliance Management* provides that at a minimum, a FRFI should establish a regulatory compliance management (RCM) framework including the following, administered through a methodology that establishes clear lines of responsibility and a mechanism for holding individuals accountable: (i) role of the CCO; (ii) procedures for identifying, risk assessing, communicating, effectively managing and mitigating regulatory compliance risk and maintaining knowledge of applicable regulatory requirements; (iii) day-to-day compliance procedures; (iv) independent monitoring and testing procedures; (v) internal reporting; (vi) role of Internal Audit or other independent review function; (vii) adequate documentation; (viii) role of Senior Management, and (ix) role of the Board.

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			Procedures for Identifying, Risk Assessing, Communicating, Managing and Mitigating Regulatory Compliance Risk and Maintaining Knowledge of Applicable Regulatory Requirements Reasonable procedures should exist to assure that appropriate individuals are provided with current and accurate information needed to identify, assess, communicate, manage and mitigate regulatory compliance risk, and maintain knowledge of applicable regulatory requirements. The procedures should enable a FRFI to take a risk-based approach to managing regulatory compliance risk so that appropriate resources are allocated to higher risk areas. The information provided should be updated, as necessary, to reflect new and changing regulatory requirements. In addition, such procedures should assure that information is updated when changes with respect to products, services, strategic plans, other activities and corporate structure are made. **Day-to-Day Compliance Procedures** Appropriate procedures should exist in operational management to reasonably assure that a FRFI is complying on a day-to-day basis with the regulatory requirements applicable to the activities of the FRFI. Such procedures should be tailored to the business activities. They should be incorporated into, and maintained in, relevant business operations. The procedures should also include a monitoring and testing component using a risk-based approach to

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			reasonably assure the adequacy of, adherence to, and effectiveness of such procedures in business operations. In addition, OSFI Guideline B-7 *Derivatives Sound Practices*, sets out expectations with respect to risk management relating to the use of derivatives, reporting requirements to trade repositories and capital requirements for derivatives transactions. **Prudent Business Practices** Section 465 of the *Bank Act* (and Sections 492 and 615 of the *Insurance Companies Act*) require the board of a FRFI to establish investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return. Furthermore, a number of OSFI guidelines set out prudential limits and restrictions, including OSFI Guideline B-1 *Prudent Person Approach* and OSFI Guideline B-2 *Large Exposure Limits.* OSFI Guideline B-1 outlines factors that OSFI expects the management and the board of directors of a financial institution to consider in establishing investment and lending policies and in ensuring that they are effectively implemented. Pursuant to OSFI Guideline B-2, FRFIs are also expected to have in place the management information and control systems necessary to give effect to their written policies on large exposures. OSFI has also issued Guidance Note 03/2001 *Large Exposure Limits* providing additional guidance on the application of Guidelines B-1 and B-2. **Risk Management Duties**

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			Section 157 of the *Bank Act* imposes a duty on the board of directors of a bank to manage or supervise the management of the business and affairs of the bank (there is a similar requirement under Section 165 of the *Insurance Companies Act*). The OSFI *Corporate Governance Guideline* ("**OSFI Corporate Governance Guideline**") requires that each FRFI establish a risk appetite framework ("**RAF**") that: • Guides the amount of risk the FRFI is willing to accept in pursuit of its strategic and business objectives. • Sets basic goals, benchmarks, parameters, and limits, and should consider all applicable types of risks. • Contains all elements required by an annex to the Corporate Governance Guideline, including a risk appetite statement, specific risk tolerance limits, and processes for implementation of the RAF. Further, the OSFI *Corporate Governance Guideline* states that D-SIBs should establish a dedicated risk committee to oversee risk management on an enterprise-wide basis, and that the oversight of the risk management activities of the bank are to be independent from operational management, adequately resourced, and have appropriate status and visibility. OSFI Guideline B-7 *Derivatives Sound Practices* states that each FRFI should ensure that each derivative product traded is subject to a product authorization signed off by senior management, and sets forth OSFI's

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			expectations with respect to having documented policies and procedures for risk management, creating risk tolerance limits, and measuring, reporting, managing, and controlling the risks associated with the derivatives business, including market, currency, interest rate, equity price, commodity price, credit, settlement, liquidity, operational, and legal risks. Finally, OSFI's oversight pursuant to the *Supervisory Framework* will assess the extent to which the risk management function integrates policies, practices, and limits with day-to-day business activities and with the bank's strategic, capital, and liquidity management policies. Under the Supervisory Framework, OSFI will assess whether the risk management function effectively monitors risk positions against approved limits and ensures that material breaches are addressed on a timely basis. OSFI will look at various indicators, including the extent to which the bank proactively updates its policies, practices, and limits in response to changes in the industry and in the institution's strategy, business activities and risk tolerances.
OSFI	OSFI Guideline E-13 *Regulatory Compliance Management* OSFI *Corporate Governance Guideline*	Compliance officer – s. 33(1), 33(2), 34, 31	OSFI Guideline E-13 *Regulatory Compliance Management* ("RCM Guideline") provides the CCO should be responsible for assessing the adequacy of, adherence to and effectiveness of the FRFI's day-to-day controls, and for providing an opinion to the Board whether, based on the independent monitoring and testing conducted, the RCM controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide. Pursuant to the RCM Guideline:

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			• The compliance oversight function should be designated to a member of senior management as the bank's CCO; • Such CCO should have sufficient stature, authority, resources, and access to achieve compliance with applicable law; • Such CCO should have appropriate skills and knowledge to effectively fulfill the requirements of the function; • The CCO should approve the content and frequency of reports and that such reports should be sufficient to enable the CCO, senior management, and the bank's board to discharge their compliance responsibilities; • OSFI expects that each bank's RCM framework will include identification, assessment, communication, and maintenance of applicable regulatory requirements, compliance procedures, monitoring procedures, and reporting procedures; • OSFI expects the CCO to be responsible for the RCM framework and to report issues directly to the board, including any material compliance issues and their remediation; and • Normal course reports to the board should be made no less than annually, and contain discussion of material weaknesses, non-compliance issues, and remedial action plans.

			In addition, the OSFI Corporate Governance Guideline states that the FRFI's board of directors should be responsible for the selection, performance, management, compensation, and evaluation of a CCO.

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August 31, 2017

VIA ELECTRONIC MAIL (consultation-en-cours@lautorite.qc.ca and comments@osc.gov.on.ca)

RE: CSA Notice and Request for Comment
93-101 Derivatives: Business Conduct

Dear Mses. Beaudoin and Knakowski:

Associated Foreign Exchange, ULC ("**AFEX**" or the "**Company**") hereby provides comment to the Alberta Securities Commission; Autorité des marchés financiers; British Columbia Securities Commission; Financial and Consumer Services Commission, New Brunswick; Financial and Consumer Affairs Authority of Saskatchewan; Manitoba Securities Commission; Nova Scotia Securities Commission; Nunavut Securities Office; Ontario Securities Commission; Office of the Superintendent of Securities, Newfoundland and Labrador; Office of the Superintendent of Securities, Northwest Territories; Office of the Yukon Superintendent of Securities; and Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island (collectively the "**Regulators**") on Proposed National Instrument 93-101 and Proposed Companion Policy 93-101CP (jointly the "**Proposed Instrument**"). AFEX wishes to express its gratitude to the Regulators for providing the opportunity to comment on the Proposed Instrument. AFEX commends the efforts of the Regulators to progress towards a harmonized derivatives registration and business conduct regime across Canada.

Background

The Company, together with its group of affiliated entities, offers bespoke global payment solutions and foreign exchange risk management products to small and medium-sized businesses located throughout the world. In conjunction, these global payment solutions and foreign exchange risk management products allow a segment of business enterprises,

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traditionally underserved by large financial institutions, to seamlessly address all their international payable and receivable obligations. Because these payable and receivable obligations are often denominated in a foreign currency, AFEX's clients are exposed to the risk of pecuniary loss resultant from the inherent volatility of the foreign exchange markets. In order to satisfy its clients' demand to better manage this currency risk, the Company offers foreign exchange spot contracts, deliverable foreign exchange forwards with a specific delivery date, and deliverable foreign exchange forwards that allow for delivery over a predetermined range of dates. The aforementioned contracts are only offered to clients that seek to mitigate an underlying commercial risk. AFEX does not offer these products to entities seeking to use them for purely speculative investment purposes.

AFEX is a British Columbia unlimited liability company with a principal place of business in Toronto, Ontario. The Company offers the abovementioned products and services strictly to persons residing throughout Canada. In addition to its Toronto office, the Company maintains satellite offices in Montreal, Quebec; Ottawa, Ontario; and Vancouver, British Columbia. Due to the nature of its activities, AFEX is registered with the Financial Transactions and Reports Analysis Centre of Canada as a money services business. Furthermore, because of its operations in Quebec, the Company is also registered as a money services business with the Autorité des marchés financiers.

Comments

AFEX urges the Regulators to reexamine the Proposed Instrument's definition of eligible derivatives party to ensure that it accurately distinguishes market participants that possess the financial awareness that allows for less rigorous business conduct protections from those participants that lack the adequate level of financial knowledge and therefore benefit from enhanced protections. For the purpose of this letter, the Company wishes to focus on the class of entities enumerated in clause (m) of the definition of eligible derivatives party. Clause (m) establishes a conjunctive bipartite test that mechanically attempts to evaluate an entity's financial sophistication. First, the market participant must explicitly represent in writing that it possesses the requisite knowledge and experience to fully understand the derivative ("**Financial Acumen Prong**"). Assuming the entity satisfies the Financial Acumen Prong, it must next demonstrate that it has net assets of at least $25 million as of its most recently prepared financial statements ("**Financial Threshold Prong**"). Should the entity satisfy both the Financial Acumen Prong and the Financial Threshold Prong, it qualifies as an eligible derivatives party under clause (m).

The Company believes that the Financial Acumen Prong both efficiently and effectively achieves the primary objectives of the Regulators; to protect investors and counterparties, reduce risk, improve transparency and accountability, and promote responsible business conduct in the over-the-counter derivatives markets. Through the Financial Acumen

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Prong, the Regulators can better ensure that parties to a bilateral over-the-counter derivative are fully aware of the nuances and risks involved with such a financial product. Additionally, the Financial Acumen Prong achieves these primary objectives without imposing significant pecuniary burdens or operational inefficiencies on market participants. Therefore, the Company is confident that, through the Financial Acumen Prong, the Regulators achieve their policy objectives without causing a disruption to the over-the-counter derivatives marketplace.

Although AFEX is in agreeance with the inclusion of the Financial Acumen Prong, it believes the Regulators should reassess the Financial Threshold Prong. The Company recognizes the importance of including a financial benchmark in the definition of eligible derivatives party. However, the Company disagrees with the Regulators as to the appropriateness of the $25 million net assets threshold. Net assets alone fail to accurately and completely paint the picture of an entity's financial wellbeing or its market sophistication. It is common for closely held small and medium-sized businesses to implement fiscal plans that involve large regularly scheduled dividends to their equity holders. Through the use of a net assets based approach, these entities, although plausibly just as financially savvy as an entity that retains a large portion of its earnings, would likely struggle to satisfy the Financial Threshold Prong. That is, because the Financial Threshold Prong ignores other fiscal metrics, such as current assets, liquidity, revenue, or equity, it will not accurately identify those market participants that have an enhanced level of sophistication in the over-the-counter derivatives marketplace.

The Company asks that the Regulators look to the precedent established by their international counterparts for guidance in establishing a suitable economic metric for the Financial Threshold Prong. In the United States, the Commodity Exchange Act establishes a class of advanced persons known as eligible contract participants. Among other things, an entity may qualify as an eligible contract participant if it has either total assets in excess of USD $10 million or a net worth of at least USD $1 million.[1] Through the inclusion of both an assets-based threshold and an net worth-based threshold, the eligible contract participant definition accounts for differences in firms' earnings distribution strategies. Additionally, AFEX believes that the quantitative benchmarks used in the eligible contract participant model are much more appropriate than that established in the Financial Threshold Prong. The Company is not convinced that a firm with net assets of $25 million is any more cognizant of the risks associated with the over-the-counter derivatives market than a company with USD $10 million in assets or USD $1 million net worth. The use of the Financial Threshold Prong will cause many small and medium-sized enterprise market participants that for years have relied on over-the-counter derivative products to mitigate their currency risk to suddenly be swept into class that requires enhanced counterparty oversight. By doing so, these counterparties will likely receive less

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[1] *See* 7 U.S.C. 1a(18)(A)(vi).

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advantageous pricing, as the derivatives firm will pass along the costs associated with their adherence to the provisions of the Proposed Instrument.

In the event the Regulators do not wish to alter the definition of eligible derivatives party, AFEX believes a client categorization regime similar to that established in the European Union's Markets in Financial Instruments Directive is a reasonable alternative. The European Union employs a categorization regime whereby counterparties deemed to lack the requisite level of financial sophistication are permitted to waive the application of the rules of conduct. This regime essentially creates an additional tranche of counterparty sophistication. Waiver is permitted if the entity satisfies any two of the following elements: (1) The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters, (2) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500,000, or (3) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.[2] Counterparties that fall outside the scope of the regime's sophisticated counterparty definition are nonetheless provided the opportunity to be treated under the same standards as those counterparties determined by rule to be sufficiently savvy. As discussed above, AFEX strongly believes that compliance costs associated with carrying out the Proposed Instrument's business conduct standards will adversely impact the pricing of over-the-counter derivative products. As such, a counterparty that might lack the financial wherewithal to qualify as an eligible derivatives party but possesses sufficient financial knowledge and experience should have the option to waive certain business conduct standards to ensure optimal pricing. Although AFEX recognizes that waiver is not appropriate for all market participants, it believes that the Markets in Financial Instruments Directive correctly identifies that class of participants who possess the market knowledge to evaluate the benefits and perils associated with derivative products. Specifically, through the consideration of financial industry experience and transaction history, the rule becomes sufficiently flexible to ensure the avoidance of any disruptions to market participants that possess the sophistication but merely fail to satisfy the Financial Threshold Prong.

In conclusion, the Company proposes that the Regulators either amend the Financial Threshold Prong to include a threshold that more accurately captures investors that are able to fully assess the suitability of over-the-counter derivative products and therefore present little likelihood of suffering financial loss from inappropriate transactions. Alternatively, AFEX believes the Regulators should allow for market participants with advanced financial experience to waive certain costly provisions of the Proposed Instrument. The Regulators note that the Proposed Instrument rule was drafted to meet the international standards of major trading

[2] *See* DIRECTIVE 2014/65/EU, Annex II

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jurisdictions. The implementation of either of the aforesaid enhancements allows the Regulators to better align the proposed rule with this objective.

*   *   *

AFEX appreciates the opportunity to comment on the Proposed Instrument and wishes to express its gratitude to the Regulators for the initiative taken to enhance over-the-counter derivatives regulation throughout Canada.

Sincerely,

Anthony L. Rodriguez
Chief Risk Officer

Cc: Brian M. Spahn, Regulatory Affairs Manager, AFEX

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VIA EMAIL

August 31, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention: Grace Knakowski, Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor,
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Proposed National Instrument 93-101 – *Derivatives: Business Conduct*

Franklin Templeton Investments Corp. ("FTIC") is writing to provide comments with respect to the Canadian Securities Administrators' ("CSA") Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (the "Business Conduct Rule").

FTIC is currently registered in most provinces and territories in Canada as an adviser, investment fund manager, mutual fund dealer and/or exempt market dealer. FTIC is also

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registered with the Ontario Securities Commission as a commodity trading manager. FTIC is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin, Templeton, Franklin Bissett, Franklin Mutual Series, Franklin Templeton and Franklin Quotential funds and institutional accounts. In Canada, FTIC has almost 500 employees providing services to nearly 500,000 unitholder accounts and over 100 pension funds, foundations and other institutional investors.

FTIC and its affiliates do not engage in the business of what would constitute a "Derivatives Dealer" under the Business Conduct Rule, but do engage in the business of what would constitute a "Derivatives Adviser"; therefore, our comments are limited to the impact of the Business Conduct Rule on Derivatives Advisers.

The Business Conduct Rule would impose a range of business conduct requirements on FTIC as well as its foreign affiliates engaged in the business of advising Canadian clients in connection with transacting in derivatives in any Canadian province or territory ("Jurisdiction"). The CSA initially indicated that a separate rule setting out the obligation to register as a Derivatives Adviser would be issued in conjunction with the Business Conduct Rule (the "Derivatives Registration Rule"), but since the Derivatives Registration Rule has not yet been issued for comment, it is difficult to fully gauge the impact of these proposals in order to provide comments. Consequently, we are providing initial comments on the Business Conduct Rule, but we may have additional comments in light of the Derivatives Registration Rule and its impact on both the Business Conduct Rule and our business.

Definition of Derivatives Adviser

The Business Conduct Rule will apply to market participants that are "engaging in the business of advising others as to transacting in derivatives". It is implied that the person or company must be either located in a Jurisdiction or advising a person or company located in a Jurisdiction, but this does not appear to be explicitly stated. We believe it is imperative that the CSA clarify the intended jurisdictional scope of this definition.

The proposed companion policy to the Business Conduct Rule provides a non-exhaustive list of factors to be considered under the business trigger test; however, we believe that in addition to the exemption in section 43(2) for persons providing general advice, the definition of Derivatives Adviser should exclude professionals whose advisory services are solely incidental to their business or profession.

Furthermore, there is also no concept of a de minimis threshold for incidental advice. For example, an investment adviser may generally advise a client on securities but also employ a currency hedge on the account. Under the business trigger test in the Business Conduct Rule, the investment adviser could be viewed as a Derivatives Adviser, although that is not the intent of the strategy employed, since the use of derivatives is only incidental to the investment strategy.

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Definition of Eligible Derivatives Party

The concept of "Eligible Derivatives Party" ("EDP") is different from the concept of "permitted client" in National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registration Obligations* ("NI 31-103") and seems to exclude parties that are deemed to be sophisticated investors under NI 31-103. The definition of EDP does not include various entities that should be included, for example mutual fund dealers, exempt market dealers and charities. Nor does the definition of EDP take into consideration the commercial hedger exception that is found in the securities legislation of many of the Jurisdictions. Commercial hedgers, other registrants and large institutional investors are persons and entities that are sophisticated users of derivatives for risk management purposes who do not need the benefit of many of the requirements set out in the Business Conduct Rule. FTIC urges the CSA to align the EDP definition with the definition of permitted client in NI 31-103, and add the commercial hedger definition to reflect the nature of the derivatives marketplace.

The Business Conduct Rule requirements are divided into two tiers, the first tier applying to advisory activities for all classes of derivatives parties. Only a subset of the Business Conduct Rule requirements is intended to apply to dealings with EDPs, including individuals who are EDPs and who have waived in writing the protections under the Business Conduct Rule (the "Exempt EDPs").

However, the Business Conduct Rule would require a Derivatives Adviser to apply all the requirements of the Business Conduct Rule whenever it is advising a managed account, even when the owner of the managed account is an EDP. FTIC's managed account clients are typically large institutional investors (pension plans, insurance companies, charitable organizations and endowments) or other investment funds. The full application of the Business Conduct Rule to these types of accounts would be onerous, impractical and unnecessary. FTIC strongly believes that, in connection with its managed accounts, it should be able to look through to the EDP status of its underlying clients. FTIC submits that EDPs are sophisticated investors, and they should not be treated like non-EDPs simply because they have chosen to obtain advice and to invest through a managed account structure.

Furthermore, under the Business Conduct Rule, Derivatives Advisers will be required to conduct due diligence and obtain written representations from certain categories of EDPs, and to update this information periodically. Institutional clients will be required to represent in writing that they have the requisite knowledge and experience to evaluate the information provided to that person or company about derivatives, the suitability of the derivatives for that person or company and the characteristics of the derivatives to be transacted on the person's or company's behalf. The requirement for this level of representation, and the need to update these confirmations periodically, is onerous and does not achieve any additional protection. The different treatment of sophisticated investors under NI 31-103 and the Business Conduct Rule is confusing and, in FTIC's view, unnecessary.

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Fair Dealing, Conflict of Interest, Derivatives Party Specific Needs and Objectives, Suitability and Fair Terms and Pricing

These provisions already exist for advisers under NI 31-103. Furthermore, these obligations are already covered by the fiduciary duty owed by an investment adviser to its clients, and FTIC does not believe that it is appropriate to impose specific requirements in connection with this duty in the context of derivatives. Further, imposing duplicative requirements between NI 31-103 and the Business Conduct Rule will complicate compliance with the established standards and practices that are already observed by investment advisers.

Senior Derivatives Manager

Under the Business Conduct Rule, a "Senior Derivatives Manager" must be designated for each derivatives business unit as responsible for directing derivatives activities of that unit. It is our understanding that it is likely that the Senior Derivatives Manager will not a compliance person. The Senior Derivatives Manager is required to take "reasonable steps to prevent or respond to non-compliance". It is unclear what this means and the consequences of a failure to do so. In particular, the imposition of a responsibility to prevent non-compliance is not appropriate. The Senior Derivatives Manager requirement will create a regime that is different than, and inconsistent with, the regime under NI 31-103.

In addition, the Senior Derivatives Manager requirement is also not consistent with most global derivative requirements. If foreign advisers are required to incur the cost and complexity of implementing such a regime just for Canadian clients, it would be a major disincentive to continuing to provide derivatives advisory services to Canadian clients. The imposition of a Senior Derivatives Manager regime could result in many foreign advisers ending cross-border advisory services in Canada. FTIC does not believe that it is appropriate to create a special regime that is largely limited to derivatives in Canada.

Foreign Advisers

Since the Business Conduct Rule does not specify the exemptions that may be available to foreign advisers, it is difficult to comment on the impact of the Business Conduct Rule to FTIC's foreign affiliates.

Conclusion

The differing concepts and protections for various types of investors under NI 31-103 and the Business Conduct Rule are confusing and unnecessary. FTIC strongly recommends that the CSA draft an integrated rule for all types of investments, especially since a typical client account would hold a mix of securities and derivatives. Having a different set of rules and exemptions for derivatives will increase administrative and compliance burdens, with no corresponding investor benefit.

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Furthermore, the CSA should allow industry participants to provide additional comments on the Business Conduct Rule once the Derivatives Registration Rule is released since both rules are so inter-connected.

Thank you for your consideration of this submission. Please feel free to contact FTIC at 416.957.6010 should you have any questions or wish to discuss this submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

"Brad Beuttenmiller"

Brad Beuttenmiller
Senior Associate General Counsel

INCLUDES COMMENT LETTERS

August 31, 2017

Hello;

For proposed national instrument 93-101, NorthPoint Energy Solutions, Inc. would like to submit the following comment:

Whether or not a person or company is in the business of trading or advising in derivatives is dependent on if they meet the definition of a ‘derivative advisor’ or a ‘derivative dealer.’ However, an organization can be exempt from the proposed instrument provided it does not engage in certain activities outlined in section 39. Based on this proposed instrument, we are trying to determine whether the intent of the instrument is to capture firms involved in trading commodities; and specifically whether or not the proposed instrument is applicable to our business.

If a derivative dealer is defined as “a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in derivatives as principal or agent,” a commodity firm trading contract for differences (a fixed for floating swap) for their own purposes with another commodity firm would be included in this definition. Is the intent of the definition of a ‘derivative dealer’ to capture commodity firms trading amongst themselves in the over the counter market? If not, can there be an exemption put in place to exclude commodity firms trading with one another from the definition of a ‘derivative dealer’?

If a commodity firm meets the definition of a ‘derivative dealer’ and transacts in derivatives for their own end use, they may still not be exempt from the proposed instrument. For example, our firm has ISDA master agreements in place with other firms that allow us to regularly place offers or bids with other firms. We enter into these contracts for speculative and hedging purposes. This type of transaction is not exempt from the proposed instrument as we are quoting prices at which we would be willing to transact. We believe this coincides with question 5: Business Trigger Guidance- Quoting prices or acting as a market maker – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives. Is the intent of the exemption listed in paragraph 39c to capture commodity firms trading amongst themselves in the over the counter market? If not, can the exemption be worded to exclude commodity firms trading with one another?

Our understanding of the overall intent of the proposed instrument is that it is geared toward protecting investors. Firms entering into the transactions outlined above have a high level of sophistication, the necessary background, and appropriate knowledge to properly understand and assess the risks involved in such transactions. For these reasons, we are asking that our questions be given reasonable consideration.

Thank you;

Drew Broadfoot

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Advancing Standards™

August 31, 2017

Alberta Securities Commission
British Columbia Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Nunavut Securities Office
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Notice and Request for Comment - Proposed National Instrument 93-101 – ***Derivatives: Business Conduct*** **and Proposed Companion Policy 93-101CP -** ***Derivatives: Business Conduct***

The Portfolio Management Association of Canada ("**PMAC**"), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the Canadian Securities Administrators' ("**CSA**") Notice and Request for Comment - Proposed National Instrument 93-101 – *Derivatives: Business Conduct* ("**NI 93-101**") and Proposed Companion Policy 93-101CP - *Derivatives: Business Conduct* (the "**Consultation**"). Capitalized terms used in this letter but not defined here have the same meaning given to them in the Consultation.

OVERVIEW

PMAC represents investment management firms registered to do business in Canada as portfolio managers. PMAC members encompass both large and small firms managing total assets in excess of $1.5 trillion for institutional and private client portfolios[1].

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. PMAC consistently supports measures that we feel elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole. We support the CSA's aim to establish a robust investor protection regime that meets the International Organization of Securities Commissions' ("**IOSCO**") standards with respect to over-the-counter ("**OTC**") derivatives.

PMAC'S APPROACH TO THIS CONSULTATION

PMAC supports the work of the CSA to ensure that all derivatives firms remain subject to certain minimum standards in relation to their business conduct towards both investors and

[1] For more information about PMAC and our mandate, please visit our website at: www.portfoliomanagement.org.

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counterparties. We applaud the work of the CSA to develop and adopt a harmonized derivatives registration and business conduct regime across Canada. We believe that the establishment of a national regime is a positive step for industry, the Canadian economy, and investors. We note, however, that the Consultation is primarily focused on addressing policy issues arising from dealing activities and does not identify specific issues with respect to the activities of advisers, particularly portfolio managers, vis-à-vis derivatives. Therefore, PMAC does not see a compelling policy rationale for requiring separate market conduct rules for advisers with respect to derivatives.

PMAC does not believe that the Consultation, as it would apply to advisers, adequately accounts for the fiduciary obligations owed by advisers to their clients. Many of the specific requirements outlined in the Consultation are already addressed by the fiduciary duty owed by advisers to their clients and/or by the well-established and effective set of registration, proficiency and market conduct requirements advisers are already subject to under National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"). We do not believe that investors or the Canadian capital markets would benefit from the CSA imposing duplicative requirements on advisers in the derivatives context.

As a result, in submitting our comments and recommendations with respect to this Consultation, PMAC has assumed that the soon-to-be-published consultation on the derivatives registration regime (the "**Derivatives Registration Instrument**") will exempt firms and individuals who are registered under NI 31-103. We believe that the CSA's laudable policy objectives of creating a uniform approach and protecting participants in the OTC derivatives markets from unfair, improper and fraudulent practices can be best achieved for advisers by leveraging NI 31-103 with some minor amendments and/or through granting substituted compliance.

The CSA have acknowledged that the Consultation proposes to introduce several requirements that are similar to existing market conduct rules in NI 31-103 which have been tailored to reflect the derivatives markets. PMAC strongly believes that minor modifications to NI 31-103 - including exemptions where appropriate - to set out a complete code of conduct for registrants would be the most effective way to regulate firms for the benefit of investors without unduly increasing the regulatory burden. PMAC also believes that additional articulation and explanation of the differences in the business conduct rules for derivatives and those set out more generally in NI 31-103 would assist stakeholders in evaluating the proposals in the Consultation.

Were the CSA to determine that existing registrants under NI 31-103 - specifically, those registered as portfolio managers - require additional proficiency or other regulations to engage in the business of advising in derivatives, we believe that such requirements should be introduced gradually and with sufficient time so as not to disrupt the existing qualifications of advisers who are currently employing derivatives for the benefit of their investors. PMAC looks forward to the opportunity to comment on the Derivatives Registration Instrument and we anticipate that several comments made with respect to this Consultation will require revision and/or further elaboration once we have reviewed the details of the registration regime.

PMAC supports the ongoing efforts of the CSA to identify opportunities to improve the investor-adviser relationship. We believe that the integrity of the client-registrant relationship is of crucial importance to confidence in the markets, a healthy economy and access to investment advice for all Canadians. PMAC is a strong believer in the importance and effectiveness of existing registration requirements and ongoing obligations. We believe that the current framework is very well considered and sufficiently principles-based so as to allow firms to responsibly discharge their duty of care toward clients while adopting innovative and effective business models and philosophies. Firms registered as portfolio managers under NI 31-103 have developed and continuously oversee finely-honed compliance regimes and adhere to the highest standard of conduct in the industry –

the fiduciary standard[2]. Portfolio management firms embrace change that will improve protection, efficiency and outcomes for investors but are wary of changes that will unduly increase regulatory burden through the establishment of separate rules and standards of conduct when fairly straightforward and less burdensome amendments to NI 31-103 would accomplish the same policy objective.

SUMMARY OF PMAC'S KEY RECOMMENDATIONS

1) For firms registered in the adviser category, codify the necessary amendments to create a derivatives business conduct regime through minor amendments to NI 31-103 to allow registrants to leverage existing compliance frameworks and to avoid increasing the regulatory burden and compliance costs without a corresponding investor protection benefit.

2) Leverage the existing sophisticated client definition of "permitted client" in NI 31-103 instead of introducing the new concept of "eligible derivatives party" or "**EDP**" and allow individual permitted clients to benefit from the carve-outs from the requirements that the CSA is willing to extend to non-individual EDPs as set out in the Consultation.

3) Reconsider the practicality and usefulness of the proposed written representation regarding an EDP's knowledge and experience pertaining to derivatives. A bright-line test based on financial resources should instead be sufficient and would be consistent with the CSA's approach in National Instrument 45-106 – *Prospectus Exemptions* ("**NI 45-106**") with the "accredited investor" definition and in NI 31-103 with the "permitted client" definition. If such a bright line test is deemed insufficient in the derivatives context, provide greater clarity as to when a firm would not to rely on representations made by an EDP.

4) Allow managed account clients that are EDPs to be included in the same carve-outs from certain requirements and protections applicable to EDPs. Managed account clients benefit from the highest duty of care owed by advisers and they do not require or want the protections that the Consultation proposes they should receive.

5) Where possible, harmonize the Canadian OTC derivatives rules with global rules such as the Commodity Futures Trading Commission's ("**CFTC**") requirements under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* to reflect the importance of the global nature of the OTC derivatives market. Specifically, ensure that business conduct requirements applicable to firms dealing with EDPs avoid duplication and/or conflict with similar existing rules in other legislation. PMAC members are concerned that an unduly onerous regime in this respect may lead global derivatives dealers to exit the Canadian market, leading to potentially adverse impacts on liquidity and systemic risk as well as to negatively impacting investors' access to quality derivatives products.

6) The Consultation goes beyond the requirements regarding collateral set out in National Instrument 94-102 Derivatives: *Customer Clearing and Protection of Customer Collateral and Positions* ("**NI 94-102**"). Provide clarification regarding the intended application of the provisions relating to the segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client

[2] This duty is currently imposed by common law across Canada and, pursuant to CSA 33-404, a statutory fiduciary will be introduced across Canada for jurisdictions that do not currently have such a duty in their securities acts.

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where the adviser has been contractually granted authority with respect to the investment and use of portfolio assets including, but not limited to, derivatives. Provide an explanation as to why the requirements for derivatives party assets set out in the Consultation are broader and more onerous than those in existing securities instruments.

7) PMAC looks forward to the opportunity to further assess and respond to these proposed requirements when the Derivatives Registration Instrument is published to ensure that our recommendation requesting greater flexibility for registered firms with respect to the senior derivatives manager requirements are workable. Provide an optional carve-out for firms registered under NI 31-103 from the senior derivatives manager requirements to allow the senior derivatives manager to be the CCO. We strongly believe that it would be most effective for registered firms to have the option and flexibility to leverage the existing role of the CCO under NI 31-103 to include derivatives matters as an extension of their obligations to monitor compliance with securities laws generally. This approach will, of course, depend on the scope of the required derivatives experience and proficiency requirements for CCOs.

8) Address concerns about how the CSA will treat foreign derivatives firms who are exempt from registration under equivalent foreign or domestic regulations but would nonetheless be required to be registered in Canada and to comply with the requirements proposed by the Consultation by virtue of tripping over the business trigger. Ensure that the international sub-adviser exemption set out in subsection 8.26.1 of NI 31-103 is included in the derivatives registration and business conduct regimes so that existing business relationships and access to investments for firms' clients will not be disrupted.

PMAC has addressed certain of the Consultation questions in further detail below. Specific questions from the Consultation are italicized.

Definition of "Eligible Derivatives Party"

Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

PMAC has significant concerns with respect to the proposed introduction of the term EDP. Similar to the concerns raised in our submission on CSA Consultation Paper 33-404[3] – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward Their Clients* ("**CSA 33-404**"), PMAC does not believe that another definition and category of a sophisticated investor should be adopted. The CSA note that they have slightly modified the "permitted client" definition in NI 31-103 to reflect some unique aspects of the derivatives markets, however, we do not feel that these differences truly warrant the inclusion of yet another sophisticated client category which will increase complexity. For instance, registered charities fall under the permitted client definition but have been excluded from the definition of EDP. We further note that permitted clients of firms will have provided representations as to their status in existing contractual arrangements and that it would be disruptive and unduly onerous to require an amendment of such contracts to capture any new sophisticated investor definition.

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

[3] Please see pages 10-11 of the linked submission.

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Similar to our submission on the proposed adoption of the definition of "institutional client" in CSA 33-404, PMAC continues to believe that the various categories of individuals included in the definition of permitted client (as defined in NI 31-103) are sufficiently sophisticated or have sufficient financial resources to protect themselves and warrant a carve-out from certain requirements and protections proposed in the Consultation, and these exclusions should not only be afforded to non-individual permitted clients or, in the case of the Consultation, non-individual EDPs. The underlying concept that the attainment of a certain threshold of financial resources can serve as a stand-in for sophistication (and, consequently, warrant exemptions from certain disclosure and protection) should not change whether the financial resources have been accumulated by an entity or by an individual.

Alternative Definition of "Eligible Derivatives Party"

Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in CSA 33-404 as the basis for the definition of EDP in the Consultation.

PMAC reiterates its concerns submitted in connection with CSA 33-404 regarding the proposed definition of "institutional client". PMAC feels that the $100 million asset threshold in this proposed definition is arbitrary and very high in the context of the Canadian securities and derivatives markets. As indicated above, we are of the view that the introduction of yet another category among the multiple definitions and monetary thresholds denoting various sophisticated client categories does not benefit investors or registrants. We do not believe that the increased complexity is supported by compelling policy reasons to require this new definition.

Knowledge and Experience Requirements in Clauses (m) and (n) of the Definition of EDP

Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

PMAC believes that it will be impractical for derivatives advisers and dealers to make the EDP determination and to manage relationships at the product level. PMAC does not believe that EDPs are any more or less vulnerable than permitted clients. As a result, EDPs should not be treated differently by requiring a representation from EDPs as to their knowledge and experience in the derivatives context. It would be appropriate for the CSA to omit the proposed requirement for a written representation as to an EDP's knowledge and experience pertaining to derivatives. Members believe that this requirement, as currently stated, is too vague and, as a result, such confirmation would be difficult to obtain from investors. Furthermore, due to the vagueness of the requirement and the ambiguity as to what "knowledge and experience" actually means in various circumstances, firms who obtain such a representation may be concerned about their ability to rely on such a statement. Members suggest that a bright-line financial resources test to ascertain the client's degree of knowledge, understanding, level of sophistication or ability to otherwise protect themselves through obtaining expert advice or through contractual negotiation, would be preferable. This approach would also be consistent with the CSA's approach in other securities instruments, such as in NI 45-106 with the categories of "accredited investor" and in NI 31-103 with the categories of "permitted client".

If it is determined by the CSA that a written representation will be required in NI 93-101, PMAC believes that the guidance in the CP to 93-101 as to when a firm is entitled to rely on a representation should be expanded to provide greater clarity. The requirement that firms ensure that the derivatives party is presented with the waiver in a clear and meaningful manner to ensure that the derivatives party understands the information presented and the significance of the protections being waived is vague. Stakeholders would benefit from additional specificity that takes into account the practicalities of giving and obtaining such waivers.

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Two-tiered Approach to Requirements: EDPs versus All Derivatives Parties

Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

PMAC generally agrees that a two-tiered approach to investor protection in the Consultation makes sense as it echoes the approach in NI 31-103 which treats permitted clients differently than retail clients and allows for a reduction in the regulatory burden where the end investor is deemed not to require certain disclosures and/or protections.

PMAC does have some specific concerns and questions about why derivatives advisers acting for a managed account of an EDP are not included in the carve-outs otherwise contemplated for EDPs. The requirements proposed in the Consultation for managed account clients that are EDPs would increase the regulatory burden and compliance costs without any meaningful enhancement to investor protection. Especially in light of the fiduciary duty owed by portfolio managers to their clients – and in light of the proposed introduction through CSA 33-404 of a statutory fiduciary duty for all registrants managing the investment portfolios of a client through discretionary authority granted by the client - we query the policy rationale for requiring such investors who are EDPs to be treated as non-EDPs simply by virtue of having a managed account.

Managed accounts are subject to the terms of an investment management agreement entered into between the investor and adviser. We believe that different treatment of managed account EDPs is unnecessary because managed account clients are often large and sophisticated institutions who neither want nor require such treatment. Managed account clients benefit from both the fiduciary obligation owed to them by their adviser as well as the contractual terms of the investment management agreement which suggests that they would require less protection than an EDP transacting directly with a dealer, not more. For example, managed account clients of portfolio managers would neither want nor require daily valuation reporting in respect of derivatives. These clients have elected to have their accounts managed by portfolio managers and, quite often, have bespoke reporting provided to them and have otherwise protected their interests through contractual negotiations. While we acknowledge that NI 31-103 does not extend certain exemptions (for example, KYC or suitability) to even the most sophisticated of permitted clients when they invest through managed accounts instead of through funds (for example, large pension plans), PMAC does not believe that such treatment of managed accounts is warranted under NI 31-103, nor should it be extended to the derivatives regime. We believe that the compliance costs associated with Section 7(3) of proposed NI 93-101 are not proportional to the benefits these sophisticated investors would receive.

Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

PMAC urges the CSA to ensure that the business conduct requirements for firms dealing with EDPs are consistent with already-existing requirements and avoid any duplication and/or conflict with existing rules. We understand that the rules in relation to tied-selling, fair terms and pricing, holding of assets, use and investment of assets and transaction confirmations, as currently proposed in the Consultation, are not harmonized with CFTC requirements. The CFTC rules have governed global market participants for a number of years and members are concerned that certain global derivatives dealers may choose to exit the Canadian OTC derivatives market rather than incurring the operational and compliance costs of implementing Canadian-specific requirements in this respect. PMAC members have voiced concerns about the negative impact this would have on liquidity and on systemic risk for Canadian market participants, including advisers and their clients.

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Derivatives Party Assets

PMAC believes that Sections 26-28 of NI 93-101 - the provisions relating to the segregation, use, holding and investment of derivatives party assets– unnecessarily go beyond the requirements regarding collateral set out in NI 94-102. PMAC members have noted that, for advisers who have been granted authority to invest and use client assets (which may include derivatives but which will also include other types of assets), compliance with these Sections of NI 93-101 will be problematic. We believe that the CSA should provide greater clarity around how these Sections apply to the assets of clients of portfolio managers. Additionally, PMAC believes that the requirements for derivatives party assets set out in the Consultation are boarder and more onerous than those in existing securities instruments without an articulation of why this broader approach is required in the context of NI 93-101.

Senior Derivatives Managers

Please comment on the proposed senior manager requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

PMAC's comments with respect to the senior derivatives manager requirements will be impacted by the details in the Derivatives Registration Instrument and, among other things, will depend on the scope of the required derivatives experience and derivatives proficiency requirements for CCOs. PMAC looks forward to the opportunity to assess these proposed requirements when the Derivatives Registration Instrument is published to ensure that the request set out in this submission is workable for firms of all sizes.

We ask the CSA to provide an optional carve-out for firms registered under NI 31-103 from the senior derivatives manager requirements to allow the senior derivatives manager to be the CCO. A separate senior derivatives manager regime should not be mandated for firms registered as portfolio managers under NI 31-103. The rules with respect to senior derivatives managers appear to be codifying certain relief and guidance provided by the Autorité des marchés financiers (the "**AMF**") which sought to allow CCOs of firms to become registered with respect to derivatives in the absence of the required derivatives experience and proficiency required by the AMF, if such firms could instead appoint a responsible person whose roles are substantially similar to those of the proposed senior derivatives manager. While we appreciate that this approach can be a more efficient way to allow a firm to be registered to advise in derivatives, as opposed to requiring compliance professionals such as CCOs to acquire derivatives proficiency and expertise, PMAC is concerned that the mandatory creation of a separate stream of compliance requirements and reporting falling on a business person may, for some firms, be unworkable and unnecessarily complex and, in fact, inadvisable.

Instead, we strongly believe that it would be sufficient to allow for registered firms to have the flexibility to leverage the existing role of the CCO under NI 31-103 to include derivatives matters as an extension of their obligations to monitor compliance with securities laws generally. This approach will, of course, depend on the scope of the required derivatives experience and derivatives proficiency requirements for CCOs. PMAC looks forward to the opportunity to assess these proposed requirements when the Derivatives Registration Instrument is published to ensure that this proposal would be workable.

Requiring a separate certification and compliance regime with respect to derivatives would serve to unnecessarily complicate the compliance function within firms while ignoring the already established and effective systems, testing, and reporting already in place at such firms. The CCO is already tasked with monitoring compliance with applicable requirements related to securities matters and it would make sense to leverage the responsibilities, proficiency, experience and skills

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of the CCO in this respect - with the assistance of a designated derivatives person to assist, should the firm so choose,- to monitor compliance with derivatives business conduct matters.

PMAC members raised a number of questions with respect to how firms can practically implement the proposed senior derivatives manager requirements, including how firms who have more than one department transacting in derivatives would assign and manage this responsibility. We understand that this will be the case for many firms who may have an individual in charge of foreign exchange working separately from a team dealing with other OTC derivatives. Conversely, the proposed requirements create challenges for firms where there is only one person transacting in derivatives being required to supervise him or herself. The CSA should seek to minimize the duplication of specific compliance reporting since the CCO is already tasked with these duties. Members also raised concerns about requiring business people who are not in a compliance role to certify compliance to the board of directors. We believe that a requirement to submit a report to the board instead of certifying to the board would be more appropriate and this would be consistent with the obligation on a CCO of a registered firm to submit a report, at least annually, to the board found in Section 5.2 of NI 31-103. Similarly, we believe that any reporting to the regulators should be the obligation of the CCO. We anticipate having further comments and potential alternative ways to satisfy the CSA's policy objectives in this respect once the Derivatives Registration Instrument has been published.

Foreign Derivatives Firms

PMAC members voiced concerns that the exemptions for foreign derivatives firms who are subject to and compliant with equivalent domestic or foreign regulations may ignore the realities of firms who are exempt from registration with the Securities and Exchange Commission in the U.S. (or equivalents elsewhere) but would nonetheless be required to register in Canada and comply with the requirements proposed by the Consultation by virtue tripping over the business trigger. PMAC will be looking to ensure that the international sub-advisor exemption under Section 8.26.1 of NI 31-103 will be extended to the registration of foreign sub-advisors in the derivatives registration and business conduct context to ensure that existing business relationships and access to investments for firm's clients will not be disrupted.

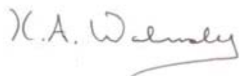
CONCLUDING COMMENTS

We would like to thank the CSA for the work, thought and outreach that has gone into developing and publishing this Consultation. We support the CSA's efforts in this respect and believe that Canadian investors and businesses are well-served by seeking to meet IOSCO's international standards for OTC derivatives. For registered advisers, we believe that this can be accomplished in a more efficient and effective manner by leveraging the existing market conduct rules and compliance framework in NI 31-103.

We would be happy to speak with you further about any of the remarks in our letter.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



Katie Walmsley
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ccua.com

August 31, 2017

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Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Newfoundland and Labrador Superintendent of Securities, Northwest Territories
Nova Scotia Securities Commission Superintendent of Securities
Ontario Securities Commission
Registrar of Securities, Prince Edward Island
Financial and Consumer Affairs Authority, Saskatchewan
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Dear Sirs and Mesdames:

RE: Canadian Securities Administrators Proposed National Instrument 93-101

On April 4, 2017, the Canadian Securities Administrators ("the Securities Administrators") issued for comment proposed national instrument 93-101 Derivatives: Business Conduct and its associated companion policy 93-101CP (NI 93-101 and NI 93-101CP). The Canadian Credit Union Association (CCUA) welcomes this opportunity to provide the Securities Administrators with comments on the proposed national instrument.

The Canadian Credit Union Association is the national trade association for 278 co-operatively structured (i.e., one-member, one vote) credit unions in Canada outside of Quebec. Together, these

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Canadian Credit Union Association

Association canadienne des coopératives financières

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ccua.com

credit unions control more than $205 billion in assets and collectively serve more than 5.6 million member/owners.

With one notable exception, credit unions are provincially-chartered co-operative not-for-profit financial institutions that exist to serve their members.[1] While credit unions generate profits for prudential and growth reasons, their primary objective is to meet the needs of their members. For 13 years running, credit unions have earned the top spot in the Ipsos "Best Banking" Awards[2] and have similarly been rated the top service provider in repeated surveys of Canadian Federation of Independent Business (CFIB) members.[3]

Credit unions in turn own and control provincial or regional centrals that provide them with wholesale financial services, liquidity management, payments processing and trade association services. These central entities include Atlantic Central (for credit unions in the Atlantic provinces), Central 1 Credit Union (for credit unions in Ontario and British Columbia) and Centrals in each of Manitoba, Saskatchewan and Alberta. Credit unions also own a federally-regulated bank called Concentra that provides wholesale financial and trust solutions to credit unions across Canada. This submission has been prepared in consultation with credit unions, Centrals and Concentra.

General Comments on the Proposed Instrument

With respect to the questions posed in CSA Notice and request for comments, we direct most of our attention to the question of the applicability of the proposed instrument and the possibility of an exemption under section 45 in Part 7 of NI-93-101. For the reasons described below, we think there are reasonable grounds for exempting the very few credit unions that could be construed as "dealers" or "advisors" from this instrument. Alternatively, we recommend *de minimus* exemption thresholds.

Notwithstanding these arguments, we offer some general comments on other elements of the proposed instrument. We are, for example, generally supportive of the two-tiered approach (Questions 1, 3 and 4) recognizing the different needs and expectations of more sophisticated end-users. We also are supportive of the ability of individuals to represent, in writing, their knowledge

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[1] In 2016, the Caisses Populaires Acadiennes became a federal credit union under the trade name of UNI Financial Cooperation.

[2] See https://ccua.com/media/2017_08_29_ipsos_best_banking_awards.

[3] For the most recent CFIB survey results, see http://www.cfib-fcei.ca/english/article/8817-battle-of-the-banks-credit-unions-among-the-best-for-small-business.html. For a news story on this topic, see: http://business.financialpost.com/management/credit-unions-lead-the-pack-in-servicing-entrepreneurs-cfib-survey/wcm/b5f0256c-af66-4c1d-a4c2-f02bb34b7cb1.

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and experience in evaluating the "characteristics of the derivatives to be transacted." That is, our experience shows that there is a class of individuals who are capable of making informed, suitable decisions around the two products we discuss below (foreign exchange transactions and interest rate swaps).

Aligned with our arguments for a *de minimus* exemption, we are concerned about the reporting burden of providing daily valuations to the derivative party and the proposed information (question 9) on the inputs and assumptions that were used to create the valuations. As we discuss below, the credit unions that offer these products to their members do so largely based on a demand for these services by the member/customer. In the case of agricultural producers, for example, they purchase currency derivatives with the expectation of taking delivery of the currency, not to speculate in the asset. Requiring credit unions to provide them with daily valuations and the underlying inputs/assumptions would be unnecessarily burdensome. At a minimum, we would urge CSA members to consider arrangements that would allow central entities or Concentra – which again, generally make available the platforms where derivatives are transacted at the credit union level – to compile this information and make it available on behalf of credit unions.

Credit Union Applicability/Exemption

The vast majority of CCUA's 278 credit union members use derivative products strictly for their own hedging purposes. In the language of the multilateral instrument 96-101 (*"Trade Repositories and Derivatives Data Reporting"* or MI 96-101) requirements, credit unions are the local counterparty and the Centrals are the reporting counterparty for these derivative transactions.

The majority of credit unions are – from the perspective of NI 93-101 – the "derivative parties" that obtain services from a derivatives "dealer" or "advisor". They are the intended beneficiaries of the proposed market conduct rules and qualify for the "end user" exemption outlined in section 39: they do not solicit or otherwise transact in derivatives on behalf of another person or entity nor do they advise on these products, make available regular price quotes, facilitate/intermediate transactions with another person or company, or facilitate clearing of a transaction in a derivative through a clear agency for some other entity.

That said, *some* credit unions do offer *some* products to members that could be subject to the compliance expectations outlined in NI 93-101. Before turning to these products, it is important to stress again that the vast majority of credit unions focus on providing their members with products

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that fall clearly outside the definition of "derivative"[4] including, notably deposit-based and loan-based products.

In discussions with the members of our trade association, participants identified three types of products that might be construed as (a) meeting the definition of "derivative" and (b) be delivered by credit unions in such a way that they fall under the scope of the proposed market conduct rules. These are: currency derivatives, interest rate swaps on loan products, and index-linked term deposit accounts. In all three instances, the products are typically made available with the assistance of a central or Concentra either through a white-label platform (currency derivatives) or other means.

After careful investigation, we concluded that index-linked products do *not* meet the definition of derivative because they are fully-insured (by provincial deposit insurers) deposit products. Under CSA Multilateral Instrument 91-101, *Derivatives: Product Determination* (MI 91-101), deposit products are prescribed as not being derivatives by subparagraph 2(f).[5] Moreover, the delivery of these products do not satisfy most of the criteria used to determine whether an entity is a "derivative advisor" or "derivative dealer."

In the table below, we evaluate the credit union's role in delivering these products relative to the "derivative advisor/dealer" criteria. These criteria are referred to as a "non-exhausting list of factors" that should be "applied holistically" in the companion document. On our conversations with members, we attempted to obtain estimates of the number credit unions offering one or more of these two aforementioned products. Based on this effort, we estimated a total of 11 credit unions currently offer currency derivatives to their members. This is less than 4% of 280 CCUA's credit

4 In CSA Multilateral Instrument 91-101, Derivatives: Product Determination, a contract or instrument that is "evidence of a deposit" is considered an "excluded derivative." Similarly, "additional contracts not considered to be derivatives" includes – according to the companion policy – "a consumer or commercial contract to...obtain a loan or mortgage, including a loan or mortgage with a variable rate of interest, interest rate cap, interest rate lock or embedded interest rate option."

5 Paragraph 2(f) reads: A contract or instrument is prescribed not to be a derivative if it is "evidence of a deposit issued by a credit union or league to which the Credit Unions and Caisses Populaires Act, 1994 or a similar statute of Canada or a jurisdiction of Canada (other than Ontario) applies..." In Saskatchewan, however, a view emerged in the context of MI 96-101 that ILA deposits were not "specified derivatives" for the central but were for credit unions. This perspective appears to be grounded in the fact that SaskCentral is exempt from the Securities Act, 1998 leaving only credit unions as possible reporting entities. Notwithstanding this perspective, we think that for the purposes of MI 93-101, this matter should be revisited since it is a market conduct rule and not a reporting rule and ILA are clearly deposit products insured by provincial deposit insurers. There is no exposure risk to the member/owner/client. Further, we understand that there are discussions underway to provide credit unions with an exemption from the application of MI 96-101 based on arguments similar to those presented here: the ILAs represent small dollar activity amounts that do not justify the related regulatory burden and, in any case, the underlying data are already effectively captured in reporting to the trade repository.

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union members. In addition, we understand that usage at these 11 credit unions is limited. For example, of the three credit unions that offer currency derivatives in Manitoba and Saskatchewan, only one credit union has more than three members that utilize the product. While we do not have estimates on the number of credit unions that offer interest rate swaps to their members, there is good reason to believe that fewer than 11 of them do and, moreover, there probably is considerable overlap with the credit unions that offer currency derivatives.

Requirement to be a derivatives dealer/advisor	Currency hedging	Interest rate swaps
	Provide FX forwards to members	Hedge risks associated with treasury activities
Made available to members/customers?	Yes, typically agricultural or business members.	Yes, typically larger commercial members.
Routinely provides price quotes?	Not directly. Centrals/Concentra make available platform.	Not directly. Credit unions works through a Central/Concentra intermediary.
Acting as a market maker?	No, back-to-backing transaction with national banks, who are the market makers.	No, back-to-backing transaction with national banks, who are the market makers.
Engaging in an organized and repetitive manner?	No, Transactions are infrequent, *ad hoc* and for commercial purposes, not speculation.	No, Transactions are infrequent, *ad hoc* and for commercial purposes, not speculation.
Facilitating or intermediating transactions?	Yes, credit union facilitates member access to service through platform but is mostly demand-led process.	Yes, credit union facilitates access to swap but demand-led process.
Transacting with the intention of being compensated?	Yes. Credit unions may receive a fee from platform provider for transaction.	Yes. Credit unions may receive a fee from platform provider for transaction.
Directly or indirectly soliciting in relation to derivatives transactions?	Yes. Largely a member initiated process (i.e., demand-led)	Yes. Largely a member-initiated process (i.e., demand-led)

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Engaging in activities similar to a derivatives adviser or derivatives dealer?	Yes.	Yes
Providing derivatives clearing services?	No	No

In weighing these criteria, we are mindful of the CSA's comment that not all the factors "necessarily carry the same weight or that any one factor will be determinative." That is, we take a holistic approach to weighing the criteria. We are also cognizant of the extent to which the credit union engage "in the activities discussed above in an organized and repetitive manner."

Based on the table analysis, we think there are reasonable grounds for arguing that those credit unions that make these products available should not be defined as derivative "dealers" or "advisors" and should, therefore, fall outside the scope of the proposed instrument. As noted in the table, credit unions make available these products largely "on demand" to provide the full suite of services demanded by their commercial and agricultural members as well as more wealthy individuals. If they did not offer these services, they would risk losing those members to competitors. It is also worth bearing in mind that they do not themselves operate the platforms (where applicable), are not themselves the market maker nor the entity offering the quotes (other than indirectly). Finally, the number of members who use these services at the 11 credit unions that offer them is extremely low.

A Credit Union *De Minimis* Exemption

CCUA believes the CSA should apply "proportionality" and a "risked-based" policy lenses to national instruments like MI 93-101. These principles are widely used by a range of regulators, including provincial credit union regulators but also the Office of the Superintendent of Financial Institutions (OSFI), the federal market conduct regulator, the Financial Consumer Agency of Canada (FCAC) and the Basel Committee on Banking Supervision (BCBS)[6].

The application of these principles hinges on the idea that "one-size-fits-all" policies harm competition because of their disproportionate effect on smaller institutions like credit unions. Constraints on competition in turn harm the consumer interests that regulatory measures often seek to protect. In this case, the compliance costs of aligning with the proposed instrument could outweigh the benefits of offering these services to members, leading to the withdrawal of these services and possibly a concentration of offerings at larger banks.

[6] For a discussion in a prudential context see: http://www.bis.org/fsi/publ/insights1.htm

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Given these competitive considerations, the application of these principles often translates into some kind of *de minimis* exemption threshold for smaller institutions engaged in less risky activities. With that in mind, CCUA recommends the addition of a *de minimis* exemption in the multilateral instrument for credit unions based on a notional dollar amount threshold. Alternatively, we would urge provincial securities regulators to consider a *de minimis* exemption by drawing on section 45 (part 7), which provides that a regulator or securities regulatory authority may grant an exemption from the instrument in whole or in part subject to applicable conditions or restrictions.

To set the threshold, the CSA could seek inspiration from the Commodity Futures Trading Commission (CFTC), which provides for a registration exemption to "persons" if the swap positions entered into "over the course of the immediately preceding 12 months have an aggregate gross notional amount of no more than $3 billion, subject to a phase in level of an aggregate gross notional amount of no more than $8 billion applied ... and an aggregate gross notional amount of no more than $25 million with regard to swaps in which the counterparty is a 'special entity'."[7]

Conclusion

CCUA is grateful for the opportunity to share its views on NI 93-101. We would be pleased to provide any additional information as required with respect to our comments. Please do not hesitate to contact me at mpigeon@ccua.com or directly by phone at 613-238-6747 x 2310.

Yours truly,

Marc-André Pigeon
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[7] See https://www.law.cornell.edu/cfr/text/17/1.3.

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August 31, 2017

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Authorité des marchés financiers
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Financial and Consumer Affairs Authority of Saskatchewan
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Nova Scotia Securities Commission
Nunavut Securities Commission
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
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Dear Sirs/Mesdames:

RE: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP (collectively the "Proposed Instrument")

Capital Power Corporation, together with its affiliates and subsidiaries (collectively, "**Capital Power**"), makes this submission in response to the Canadian Securities Administrators' April 4, 2017 requests for comments on the Proposed Instrument. Capital Power appreciates the opportunity to comment and commends the Canadian Securities Administrators ("**CSA**") for seeking public input on the Proposed Instrument.

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Capital Power is a growth-oriented North America power producer headquartered in Edmonton, Alberta. Capital Power develops, acquires, operates and optimizes power generation from a variety of energy sources, including coal, natural gas, biomass, solar and wind. Capital Power owns approximately 4500 megawatts of power generation capacity across 24 facilities in Canada and the United States and pursues contracted generation capacity throughout North America.

Capital Power hedges and optimizes its commodity portfolio using physical forward contracts for electricity, natural gas, environmental commodities (e.g. renewable energy certificates, carbon offsets and carbon credits), USD/CDN currency exchange, and financial derivative transactions based on those same commodities. Capital Power's trading counterparties include other power producers, utility companies, banks, hedge funds and other energy industry market participants. Trading activities take place primarily through electronic exchanges, such as ICE (Intercontinental Exchange) and NGX (Natural Gas Exchange), but also through third-party brokered transactions and directly with counterparties. Capital Power is a registered "market participant" in the Alberta wholesale electricity market constituted as the Alberta "Power Pool" under the *Electric Utilities Act* of Alberta (the "**EUA**") and is also a licensed "retailer" (as defined in the EUA) of electricity services to large commercial and industrial customers in the Alberta retail electricity market.

Capital Power generally supports the efforts of the CSA to establish a regulatory regime for the Canadian over-the-counter ("**OTC**") derivatives market, in order to address Canada's G-20 commitments. To that end, Capital Power respectfully urges the CSA to develop regulations that strike a balance between not unduly burdening derivatives market participants while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities.

Capital Power is a member of the International Energy Credit Association ("**IECA**") and supports and recommends all of the comments and proposed revisions to the Business Conduct Rule submitted by the IECA in its September 1, 2017 letter (the "**IECA Letter**"). In addition, Capital Power is aware of the comments submitted by Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, in a letter dated August 15, 2017 (the "**Sutherland Letter**"). Although Capital Power is not associated with The Canadian Commercial Energy Working Group, Capital Power supports the comments in the Sutherland Letter and respectfully urges the CSA to adopt the proposed revisions to the Business Conduct Rule set forth in the Sutherland Letter.

COMMENTS:

Capital Power has the following general and specific comments regarding the Proposed Instrument:

General Comments:

Timing of comment and implementation periods:

When the CSA published the Proposed Instrument for comments on April 4, 2017, the CSA indicated that it was also developing a proposed registration regime for derivatives dealers, derivatives advisers and potentially other derivative market participants. The CSA stated, in the Notice and Request for Comment document that published the Proposed Instrument, that it expected to publish Proposed National Instrument 93-102 *Derivatives: Registration* and a related companion policy ("**Proposed Registration Instrument**") for comment during the same consultation period as for the Proposed Instrument. The CSA

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extended the comment period for the Proposed Instrument for an additional 150 days to allow market participants and other stakeholders an opportunity to consider both proposed instruments before the comment period expired.

On June 15, 2017, the CSA published CSA Staff Notice 93-301 which stated that the comment periods for the Proposed Instrument and the Proposed Registration Instrument would not overlap. Capital Power believes that this is unfortunate because the concept of "derivatives dealer" is key to whether a party is subject to the Proposed Instrument.

Capital Power expects that the "derivatives dealer" concept will be fully vetted in the Proposed Registration Instrument. Capital Power hopes that the Proposed Registration Instrument will clarify that any exemptions to derivatives dealer registration can be relied upon not only for the purposes of the Proposed Instrument, but also for all other derivatives rules and instruments that the CSA has already enacted (like derivatives trade reporting), or may yet enact. Therefore, Capital Power respectfully requests that the CSA further extend the comment period for the Proposed Instrument so that there is overlap with the comment period for the Proposed Registration Rule. Capital Power strongly believes that the Proposed Instrument and the Proposed Registration Instrument should be moved forward and implemented together.

Alternatively, Capital Power respectfully requests that market participants be given the opportunity to submit supplementary comments on the Proposed Instrument (including comments on specific questions not addressed in this letter) during the comment period for the Proposed Registration Rule.

Specific Comments:

1. **Definition of "Eligible Derivatives Party" (CSA Question 1)**

In the Notice and Request for Comment document that published the Proposed Instrument, the CSA stated that the proposed definition of "eligible derivatives party" was generally like the definition of "permitted client" in NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Requirements*. The CSA has asked whether this proposed definition is appropriate, including whether any additional categories should be included or categories removed.

In response to this question, Capital Power would respectfully draw the CSA's attention to the fact that there are already defined terms for certain categories of sophisticated derivatives market participants contained in various provincial blanket orders (such as Alberta Securities Commission Blanket Order 91-507, "**BO 91-507**") and in the Quebec Derivatives Act; namely, the definitions of "qualified party" (provincial blanket orders) and "accredited counterparty" (in Quebec). Rather than being based on the definition of permitted client in NI 31-103, Capital Power respectfully submits that it would be more logical for the proposed definition of eligible derivatives party to be aligned with the existing qualified party and accredited counterparty definitions. In fact, Capital Power questions the need for the new proposed eligible derivatives party definition at all. The CSA could simply have adopted either, or both, the qualified party and/or accredited counterparty definition(s) in the Proposed Instrument.

With respect to aligning the proposed eligible derivatives party definition with the qualified party and accredited counterparty definitions, Capital Power specifically submits that the proposed eligible

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derivatives party definition be expanded to include the categories of entities described in clauses (p)(q)(s)(t)(u)(v)(w) and (x) of the definition of "qualified party" found in BO 91-507[1].

Without detracting from the importance of including all the categories described in those clauses of BO 91-507, Capital Power considers the following concepts to be essential inclusions to the definition of eligible derivatives party:

- An eligible derivatives party should include an entity that wholly directly or indirectly: owns; is owned by; or is under common ownership with, one or more eligible derivatives party(ies) (see clauses (t) through (v) of qualified party definition in BO 91-507);

- An eligible derivatives party should include an entity whose obligations under a derivatives transaction are fully guaranteed by an eligible derivatives party (see clause (x) of the qualified party definition in BO 91-507); and

- An eligible derivatives party should include an entity that uses derivatives to manage physical commodity risk (see clause (p) of the qualified party definition in BO 91-507).

Concerning the first two bullets above, Capital Power considers them to be essential additions to the eligible derivatives party definition because, in Capital Power's experience, many commercial energy companies that participate in derivatives markets are organized on the basis of project level entities that own specific assets (like a natural gas processing plant or a wind farm), a trading entity that engages in derivatives hedging transactions with third parties on behalf of the project level entities, and a ultimate parent entity that guarantees the obligations (derivative and otherwise) of its project level and trading entity subsidiaries. Within this corporate structure neither the project level entities nor the trading entity might individually have sufficient assets to meet any asset thresholds of the eligible derivatives party definition, but the parent-guarantor likely does have sufficient assets.

Concerning the third bullet above, Capital Power respectfully refers the CSA to the extensive comments about this concept in the Sutherland Letter (pgs. 4-7). Capital Power fully agrees with those comments and the letter's proposed amendments to the eligible derivatives party definition.

2. Knowledge and experience requirements in clause (m) of the definition of "Eligible Derivatives Party" (CSA Question 3)

The CSA has posed several specific questions about clause (m) of the definition of eligible derivatives party. Capital Power respectfully offers the following comments for the CSA's consideration.

Concerning the question of an entity representing in writing that it has requisite knowledge and experience to be an eligible derivatives party, the CSA has asked whether such representation should be limited to specific types of derivatives based on that entity's specific knowledge and experience with specific types of derivatives. Capital Power respectfully submits that requiring representations on the granular level of specific types of derivatives would be impractical and too onerous both for entities giving such representations and for those relying on them.

[1] http://www.albertasecurities.com/Regulatory%20Instruments/5330057%20_%2091-507_OTC_Trades_in_Derivatives.pdf. See clauses (p)(q)(s)(t)(u)(v)(w) and (x) in the definition of "qualified party".

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From the perspective of the entity giving such representation, every time the entity's "knowledge and experience" (which are very broad and subjective concepts) with respect to a particular type of derivative changed, that entity would likely have to give new, or revised, representations. This would create an onerous administrative burden on such entity and provide little practical benefit to the entity relying on the representation. It could require, for example, regularly re-issuing written representations to dozens, if not hundreds, of trading counterparties.

It could also potentially trigger default events, followed by transaction terminations, under derivatives trading agreements, to the extent that previously given, overly granular, representations were no longer true or reliable about a party's "knowledge and experience" with particular types of derivatives. The OTC derivatives market is often characterized by inter-related transactions among different market participants and across different commodities. Thus, a default and subsequent termination, under one derivatives transaction among two parties could spread to other derivatives transactions among different parties and adversely affect the entire market. Capital Power respectfully submits that such an unintended consequence should be avoided.

Similarly, the party relying on representations given to it concerning knowledge and experience of a derivatives trading counterparty, which in the case of the Proposed Instrument would be derivatives dealers, could conceivably be put in a position of frequently having to seek updated representations from its eligible derivative party counterparties. Such a requirement would also place undue administrative burdens on dealers, the costs of which would ultimately be passed along to their trading counterparties.

In addition, requiring regularly updated representations would significantly slow down the trade execution process. That in turn could result in some trades not getting executed at all, given the volatile prices in many derivatives markets, including for energy derivatives such as electricity, natural gas and petroleum. Nimbleness in trade execution can represent a competitive advantage for some derivatives dealers and their counterparties and undue administrative burdens jeopardize that advantage, resulting in lost trade opportunities and less competitive trade pricing.

Rather than requiring such granular level representations concerning derivatives knowledge and experience, Capital Power respectfully submits that an entity that is sophisticated enough to otherwise satisfy the criteria for being an eligible derivatives party will also be sophisticated enough to know what types of derivatives it is competent, or comfortable, transacting. Such an entity will have in place internal policies and procedures regulating its derivatives activities, including allowed product types, position limits and requisite market knowledge and experience among its trading staff. Considering these sorts of internal safety controls a general representation concerning requisite derivatives knowledge and experience should be sufficient.

Concerning the question of whether it is practical for a derivatives dealer, or adviser, to make eligible derivatives party determinations (and manage its relationships) at the product-type level versus for all purposes, Capital Power has already partially answered that question in the preceding paragraphs. In addition to the above, Capital Power respectfully submits that the CSA should clarify in the Proposed Instrument that:

- Eligible derivatives parties giving the "knowledge and experience" representation contemplated in clause (m) of the eligible derivatives party definition may give the representation within master derivatives trading agreements, or industry-wide protocols amending master trading agreements,

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and that such representations would be deemed repeated for each transaction under an applicable master trading agreements;

- Trading parties, including derivatives dealers or advisors, may rely on representations given to them by their counterparties without further independent investigation, unless the party receiving the representation had reasonable grounds to believe that the representation was false or unreliable. Reasonable grounds in such instances would be based on the "reasonable person in like circumstances" legal principle.

- The $25 million asset threshold in sub-clause (ii) of clause (m) of the eligible derivatives party definition should be based on gross assets and not net assets (both as revealed in most recently prepared financial statements). Basing the threshold value on gross assets, rather than net assets, would align the threshold in the eligible derivatives party definition with similar thresholds in the "qualified party" and "accredited counterparty" definitions discussed above, as well as in the "eligible contract participant" definition under the Commodity Futures Trading Commission's rules, albeit with a higher threshold than the CFTC's $10 million one[2].

3. Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties (CSA Question 4)

Capital Power generally agrees with the two-tiered approach to business conduct requirements set forth in the Proposed Instrument. Distinguishing between "sophisticated" and "un-sophisticated" derivatives market participants, based on the "eligible derivatives party" definition, and requiring correspondingly different levels of "protection" is both logical and consistent with other existing securities and derivatives regulations. As discussed above however, Capital Power believes that the definition of "eligible derivatives party" should be amended to better align it with the concepts of "qualified party", "accredited counterparty" and "eligible contract participant".

4. Business Trigger Guidance (CSA Question 5)

The proposed Companion Policy to the Proposed Instrument sets out factors that the CSA has described as relevant in determining whether an entity is in the business of trading or advising in derivatives, and therefore potentially a derivatives dealer. One of the factors is as follows:

> *"Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or **routinely quotes prices at which they would be willing to transact in a derivative** or offers to make a market in a derivative or derivatives." [**Emphasis added**]

Similarly, Sub-section 39(c) of the Proposed Instrument sets out that the exemptions set out in Section 39 only apply if "the person or company **does not regularly quote prices at which they would be willing to transact in a derivative** or otherwise make or offer to make a market in a derivative with a derivatives party". [**Emphasis added**]

[2] https://www.law.cornell.edu/uscode/text/7/1a, See sub-clause (A)(v)(I) in the definition of "eligible contract participant".

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The CSA has asked whether the guidance in the proposed Companion Policy along with Sub-section 39(c) appropriately describe a situation in which a person or individual should be considered a derivatives dealer because they are functioning in the role of a market maker. In response to that question, Capital Power respectfully submits that simply quoting prices, routinely or not, at which an entity would be willing to transact in a derivative should not, absent other factors, be indicative of functioning as a market maker and therefore being a derivatives dealer.

Capital Power respectfully submits that the logic underlying the assumption, set out by the CSA in the proposed Companion Policy, that it would not be reasonable for an entity that regularly quotes prices on derivatives to other derivatives parties to claim that it is an end-user hedging business activities is flawed. On this point, Capital Power notes and supports the comments made in the Sutherland Letter (pg. 3-4) which provides several energy industry-specific examples illustrating why the logic behind the assumption is wrong. The Sutherland Letter (pg. 4) also provides recommendations regarding how the CSA should revise its guidance concerning the “regularly quotes prices” language and what activities should constitute market making (e.g. regularly providing two-way quotes that are generally agnostic to price movements). Capital Power supports those recommendations and respectfully urges the CSA to adopt them.

In addition to the examples and recommendations on the “regularly quotes prices” language in the Sutherland Letter, Capital Power respectfully asks the CSA to consider how any commercial transaction of any kind would be possible if neither party ever quoted a price at which it was willing to enter into the transaction? A fundamental principle of contract law is the concept of “consideration”, or value of some kind being exchanged between the parties to a transaction. How can consideration be exchanged if neither party ever quoted a price at which it was willing to transact? Applied to derivatives transactions, how could any derivatives transaction happen, regardless of the characterization of the parties to the transaction as dealers or end-users, if neither party ever quoted a price at which it was willing to transact?

Capital Power respectfully submits that routinely quoting prices at which an entity is willing to enter into a derivatives transaction is simply an act of potentially initiating, or establishing the consideration for, a commercial transaction. This type of activity, absent other indicia of being a derivatives dealer, is entirely consistent with being a derivatives end-user that is hedging business activities. One specific example of this in the context of Capital Power’s business (also mentioned at pg. 4 of the Sutherland Letter) is that of an owner of a natural gas fired power plant that must procure natural gas in the market to run the plant.

To ensure a constant reliable supply of natural gas at optimal prices Capital Power hedges its price and supply exposure to natural gas by entering into natural gas futures and OTC forward transactions on a regular basis. It would be impossible for Capital Power to enter into these types of derivative transactions without regularly quoting prices at which Capital Power was seeking natural gas from suppliers and other derivatives market participants. This price quoting is done to try to establish acceptable prices (i.e. the consideration) for the gas transactions that Capital Power must enter to hedge its natural gas requirements. In this commercial context, Capital Power’s quoting of prices for acceptable natural gas hedges should not reasonably be interpreted as making a market in, or acting as a dealer of, natural gas derivatives.

In the alternative, if the CSA remains unconvinced by the discussion and example above and those in the Sutherland Letter on this point, Capital Power respectfully asks that Sub-section 39(c) of the Proposed Instrument be amended as follows:

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the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party ***that is not an eligible derivatives party***;

Adopting the suggested revision would better align the derivatives dealer business trigger guidance in the proposed Companion Policy, and the end-user exemption in Sec. 39, with the two-tiered approach to business conduct requirements set out generally in the Proposed Instrument. In other words, routinely quoting prices to or offering to make a market with eligible derivatives parties should not attract the same level of business conduct requirements as engaging in those activities with non-eligible derivatives parties.

5. Senior Derivatives Manager (CSA Question 10)

Section 32 of the Proposed Instrument requires derivatives firms to have policies and procedures in place that establish a system of controls to manage risks associated with the firm's derivatives activities and to ensure that individuals at derivatives firms have the requisite training and expertise to meet the firm's compliance obligations under applicable securities legislation (including the Proposed Instrument). Section 33 of the Proposed Instrument imposes certain compliance related supervisory, management and reporting obligations on "senior derivatives managers". Section 34 imposes duties related to responding to and reporting non-compliance incidents. The CSA has asked whether the proposed senior derivatives manager obligations are practical to comply with and whether they reflect existing best practices.

In response to this question, Capital Power respectfully submits that the proposed responsibilities for senior derivatives managers around compliance with securities law and derivatives regulations, including the Proposed Instrument, do not reflect current best practices. Senior derivatives managers are typically individuals that are responsible for managing the derivatives activities of the company, or a business unit within the company. As such, their primary responsibilities include ensuring the profitability of the derivatives activities that they oversee. Imposing the proposed compliance responsibilities on senior derivatives managers would put such managers into a conflict of interest position between the proposed compliance duties and their existing duties to advance the derivatives trading activities of their firms. Best compliance practices prescribe that the compliance functions within an organization be independent from the business functions to avoid, or mitigate, any inherent conflicts of interest.

For extensive discussion and examples about current compliance framework best practices and the conflict of interest the proposed senior derivatives manager responsibilities would create, Capital Power supports and recommends to the CSA the comments in both the IECA Letter (pgs. 12-13) and the Sutherland Letter (pgs. 10-11). Capital Power confirms that its own compliance framework reflects best practices by separating the compliance function from the business function; not just with respect to derivatives but for all business activities. Capital Power supports the recommendations in both the IECA Letter and the Sutherland Letter that Sec. 33 should either be removed from the Proposed Instrument, or alternatively, the proposed senior derivatives manager responsibilities should instead be designated as responsibilities of a senior compliance officer.

6. Records

Section 36 of the Proposed Instrument places certain requirements on derivatives dealers concerning keeping records related to their derivatives business activities. Although the CSA did not specifically pose any questions about the appropriateness of the recordkeeping requirements, Capital Power reiterates the

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comments in both the IECA Letter (pg. 13) and the Sutherland Letter (pgs. 11-12) that the requirements in Section 36 are too broad. They will result in additional, unnecessary compliance costs for derivatives dealers that will simply be passed along to their non-dealer counterparties.

Capital Power supports the recommendations in the IECA Letter and the Sutherland Letter that derivatives dealers' recordkeeping obligations be limited to keeping records of communications related to the negotiation of derivatives, the execution of derivatives, and any amendment or termination of derivatives. Furthermore, keeping records of telephone conversations and instant message communications should not be required if a record of those communications otherwise exists.

7. *De Minimis* Exception from Registration

As stated in the General Comments part of this letter, Capital Power hopes that the Proposed Registration Instrument, when published, will provide greater clarity around the derivatives dealer concept. As part of that clarity Capital Power respectfully urges the CSA to develop and adopt a *de minimis* threshold exception as part of the derivatives dealer definition, like the *de minimis* threshold exception (currently $US 8 billion over a 12-month period) adopted by the CFTC as part of the "swap dealer" definition. For a detailed discussion about the need for a *de minimis* threshold exception and potential approaches for developing an appropriate threshold, Capital Power respectfully urges the CSA to carefully consider and adopt the comments and proposals provided in Exhibit I to the Sutherland Letter ("*White Paper – The Need for a De Minimis Exception from Registration as Derivatives Dealers in Canadian Provinces and Proposed Approaches to Implementation*") as the CSA finalizes the Proposed Registration Instrument. The White Paper effectively addresses the risks posed to Canadian derivatives markets in the absence of a *de minimis* exception, including a reduction in market participants and the corresponding reduction in liquidity and increase in market risk. Capital Power supports the White Paper's comments and proposals.

Conclusion:

Capital Power respectfully requests that the CSA consider its comments and again expresses its gratitude for the opportunity to provide comments. If you have any questions please contact Mr. Zoltan Nagy-Kovacs, Senior Counsel, at 403-717-4622 (znagy-kovacs@capitalpower.com).

Yours Truly,

"***CAPITAL POWER***"

Per: *"Zoltan Nagy-Kovacs"*

Zoltan Nagy-Kovacs
Senior Counsel

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September 1, 2017

VIA ELECTRONIC MAIL

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy

Dear Sir or Madam:

I. INTRODUCTION

Just Energy Corp. ("**Just Energy**") respectfully submits this letter in response to the request for public comment from the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("**Proposed NI 93-101**") and the related Proposed Companion Policy ("**Proposed Companion Policy**") (collectively, the "**Proposed Instrument**").[1] Just Energy appreciates the CSA's continuous efforts

[1] *See* CSA Notice and Request for Comment on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy (Apr. 4, 2017) ("**CSA Notice**"), http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA_Notice_and_Request_for_Comment_NI_93-101.PDF.

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throughout the derivatives regulatory reform process and welcomes the opportunity to provide comments on the Proposed Instrument. Specifically, this comment letter focuses on the Proposed Instrument's definition of "eligible derivatives party" ("**EDP**"). As an experienced end-user, Just Energy has concerns about the narrow scope of the Proposed Instrument's EDP definition and its potential negative consequences.

Just Energy enters into a variety of financial derivatives as part of its business of purchasing and selling natural gas, electricity, and in connection with its JustGreen supply program. Just Energy enters into contracts with customers to provide electricity and natural gas at fixed prices and to provide comfort to certain customers that a specified amount of energy consumed will be derived from green generation or carbon destruction. These customer contracts expose Just Energy to changes in price of various commodities. To reduce its exposure to commodity market price changes, Just Energy uses financial derivatives and physical contracts to secure fixed-price commodity supply to cover its estimated fixed-price delivery and green commitments.

Just Energy's objective when using financial derivatives is to minimize commodity related risk, other than consumption changes. Accordingly, it is Just Energy's policy to hedge the estimated fixed-price requirements of its customers with offsetting hedges of natural gas and electricity at fixed prices for terms equal to those of the customer contracts.

II. COMMENTS OF JUST ENERGY

A. Potential Negative Implications if the Scope of the EDP Definition Is Not Modified.

To qualify as an EDP, a market participant like Just Energy must represent in writing that it has the "requisite knowledge and experience to evaluate the information provided to [it] about derivatives, the suitability of the derivatives for [it], and the characteristics of the derivatives to be transacted" and must have "net assets of at least $25 million."[2] As discussed further below, in comparison to current derivatives regulations, the Proposed Instrument's EDP definition is too narrow in scope, which is problematic given that there are two key regulatory implications that hinge on the EDP definition. *First*, under the Proposed Instrument, the business conduct requirements applicable to a derivatives dealer's particular transaction depend on the classification of the counterparty transacting with the derivatives dealer. Specifically, a derivatives dealer's transactions with EDPs would be subject to substantially fewer requirements than its transactions with counterparties that are not EDPs ("**Non-EDPs**").[3] *Second*, limiting derivatives transactions to counterparties that are EDPs is one of the criteria that must be satisfied for an entity to qualify for the Proposed Instrument's end-user exemption.[4]

Just Energy is concerned about the potential negative consequences if the scope of the EDP definition is not modified. Specifically, if the EDP definition is not modified, it may exclude experienced end-users that rely on efficient commodity derivative markets to manage the physical commodity risk associated with their business. As a result, such Non-EDP market participants will likely have fewer counterparty choices, and, consequently, will likely face higher prices, because (i) derivatives dealers that want to avoid more burdensome business conduct obligations may stop transacting with Non-EDPs and (ii) market participants seeking to qualify for the end-user exemption from the Proposed Instrument must not transact with Non-EDPs. Further, not only will this likely harm the Non-EDPs that rely on commodity derivatives markets, it may also have a negative impact on market liquidity and reduce the effective

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2 Proposed NI 93-101 at Section 1(1)(m).

3 *See* CSA Notice at 3-4; *see also* CSA Notice at Appendix B.

4 However, Just Energy suggests the CSA permit end-users that transact derivatives with Non-EDPs to qualify for the end-user exemption.

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function of commodity derivatives markets. In short, by using a definition of "eligible derivatives party" that is too narrow, the CSA could unintentionally be harming the markets and market participants it is trying to protect.

B. The Proposed Instrument's EDP Definition Is Too Narrow in Scope and Should Be Amended so That It Aligns with Similar Concepts in Current Derivatives Regulations.

The Proposed Instrument's EDP definition should be amended so that it aligns with similar concepts in current derivatives regulations. In general, the EDP definition should be amended so that it is more aligned with the definition of: "qualified party" in the Exemption Blanket Orders;[5,6] "accredited counterparty" under the Quebec Derivatives Act;[7,8] and "eligible contract participant" under the U.S. Commodity Futures Trading Commission's ("**CFTC**") rules.[9,10] Although the CSA generally found these concepts to be similar to that of an EDP,[11] Just Energy respectfully notes that the Proposed Instrument's EDP definition is materially different in key aspects. To make the scope of the EDP definition consistent and to help avoid negative consequences, Just Energy respectfully suggest that the EDP definition should be amended so that it takes into consideration entities that use derivatives to manage their physical commodity risk.

For entities that use derivatives to manage their physical commodity risk, EDP qualification standards that acknowledge the fact that they are mitigating physical commodity risk are appropriate because: (i) such entities are likely to be experienced with respect to the risks associated with commodity derivatives since managing those risks is integral to the day-to-day management of their business (*e.g.*, a power plant managing its natural gas supply risk); and (ii) properly managing physical commodity risk should be encouraged.

There are a number of circumstances where an experienced market participant that does not need the extra protections provided to Non-EDPs still might not meet the proposed $25 million net asset threshold to qualify as an

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5 As used herein, "**Exemption Blanket Orders**" refers collectively to the following: Alberta Securities Commission Blanket Order 91-507 *Over-the-Counter Derivatives* (Jan. 23, 2017), http://www.albertasecurities.com/Regulatory%20Instruments/5330057%20_%2091-507_OTC_Trades_in_Derivatives.pdf; British Columbia Securities Commission Blanket Order 91-501 *Over-the-Counter Derivatives* (Nov. 24, 1999), https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/91-501__BCI_/; Financial and Consumer Services Commission (New Brunswick) Local Rule 91-501 *Derivatives* (consolidated up to Jan. 11, 2015), http://www.nbsc-cvmnb.ca/nbsc/uploaded_topic_files/91-501-LR-CONS-2015-01-11-E.pdf; Nova Scotia Securities Commission Blanket Order 91-501 *Over the Counter Trades in Derivatives* (Feb. 17, 2016), https://nssc.novascotia.ca/sites/default/files/docs/Blanket%20Order%2091-501%20Feb%2017%202016%20OTC%20Derivaties.pdf; Financial and Consumer Affairs Authority of Saskatchewan General Order 91-908 *Over-the-Counter Derivatives* (Feb. 29, 2016), http://www.fcaa.gov.sk.ca/Default.aspx?DN=2fd89016-0cc1-41ca-9fab-91c69487703f.

6 The Exemption Blanket Orders, among other things, effectively exempt a market participant from the obligation to register as a derivative dealer if it limits its derivatives counterparties to "qualified parties."

7 *See* Quebec Derivatives Act at Section 3 (defining "accredited counterparty"), https://www.canlii.org/en/qc/laws/stat/cqlr-c-i-14.01/latest/cqlr-c-i-14.01.html#sec3_smooth.

8 Similar to the Exemption Blanket Orders, Section 7 of the Quebec Derivatives Act excludes transactions between "accredited counterparties" from consideration when determining whether an entity must register as a derivatives dealer.

9 *See* Commodity Exchange Act ("**CEA**") Section 1a(18); CFTC Regulation 1.3(m).

10 In the United States, the CEA requires market participants to be "eligible contract participants" in order to enter into swaps. *See* CEA Section 2(e).

11 CSA Notice at 5.

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EDP. *First*, a large company might use a standalone central hedging entity to face the market and that central hedging entity might not have $25 million in net assets on its own balance sheet. *Second*, a market participant might be a project entity within a larger company that holds specific assets (*e.g.*, a power plant or pipeline) and related liabilities, both of which might need to be hedged, but the project entity might not have $25 million in net assets. *Third*, a market participant might be a marketing entity which markets a physical commodity, such as natural gas, and the derivatives that hedge that marketing activity may serve to offset the entity's assets in a way that, for accounting purposes, minimizes net assets of an otherwise robust company.

The EDP definition should account for entities that use derivatives to manage their physical commodity risk. Specifically, Just Energy suggests that the EDP definition be amended so that entities using derivatives to manage their physical commodity business can satisfy the EDP definition without any asset qualification test. This would be consistent with the definition of "qualified party" under the Exemption Blanket Orders[12] and "accredited counterparty" under the Quebec Derivatives Act.[13] For example, the CSA could amend the EDP definition by including the language provided in the box directly below, which is from ASC Blanket Order 91-507.

> A person or company that buys, sells, trades, produces, markets, brokers or otherwise uses a commodity in its business and that executes an over-the-counter trade in a derivative provided that a material component of the underlying interest of the derivative is any of the following:
>
> (i) a commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (ii) a commodity, security or variable that directly or indirectly affects the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (iii) a commodity, security or variable for which there is a high degree of correlation between the movement in its value and the movement in the value of the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;
>
> (iv) another derivative which is not listed for trading on an exchange, where a material component of the underlying interest of that other derivative is a commodity, security or variable referred to in any of subparagraphs (i) to (iii).

As an alternative, the CSA could amend the EDP definition so that entities using derivatives to manage their physical commodity business can satisfy the EDP definition by meeting a significantly lower asset threshold, such as by meeting the threshold of either (i) total assets of at least $10 million or (ii) a net worth of over $1 million. This would be consistent with the approach taken with the definition of "eligible contract participant" under the CFTC rules.[14]

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[12] *See* ASC Blanket Order 91-507 (paragraph p of the qualified party definition); BCSC Blanket Order 91-501 (paragraph p of the qualified party definition); FCSC NB Local Rule 91-501 (paragraph q of the qualified party definition); NSSC Blanket Order 91-501 (paragraph p of the qualified party definition); FCAA Saskatchewan General Order 91-908 (paragraph p of the qualified party definition, and page 5).

[13] *See* Quebec Derivatives Act (paragraph 12 of the accredited counterparty definition).

[14] *See* CEA Section 1a(18); CFTC Regulation 1.3(m).

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As another alternative, the CSA could allow certain market participants, such as market participants hedging physical commodity risk, to "opt-in" to the EDP definition by representing that they do not need the extra protections received by Non-EDPs.

III. CONCLUSION

Just Energy appreciates this opportunity to provide input on the Proposed Instrument and respectfully requests that the comments contained herein are considered.

If you have any questions, please contact the undersigned.

Respectfully submitted,

Amir Andani
VP and Chief Risk Officer

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Financial and Consumer Services Commission (New Brunswick)
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Ontario Securities Commission
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Office of the Superintendent of Securities, Northwest Territories
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Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy (the "Proposed Rules")

The Investment Industry Association of Canada (IIAC) would like to submit its comments regarding the Proposed Rules.

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The IIAC and its Mandate

The IIAC is the national association representing the position of 131 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues.

We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

Proposed Rules and Objective

The Canadian Securities Administrators (CSA) issued the proposed National Instrument 93-101 on Business Conduct for Over-the-counter (OTC) derivatives and its proposed Companion Policy on April 4, 2017. The main objective of the Proposed Rules, as stated by the Autorité des Marchés Financiers at its roundtable, is to protect investors.

Under the Proposed Rules, various minimum standards would apply to the conduct of derivatives dealers and derivatives advisers.

Regulatory Overlap for Our IIAC Members

The IIAC and its members wish to remind the CSA of the strict regulatory framework that derivatives dealers regulated by IIROC are already subject to.

The proposed rules overlap with existing IIROC rules and regulations, as well as with the market conduct requirements applicable to registered dealers and advisers under National Instrument 31-103 "*Registration Requirements, Exemptions and Ongoing Registrant Obligations*".

For example, our members currently comply with requirements that are being addressed by the CSA in the Proposed Rules:

> Duplication on Fair Dealings:
> Our members must follow multiple requirements on fair dealings which are explained in the CSI Conduct and Practices Handbook (CPH) Course and in the firms' internal policies and procedures manual. IIAC members have a general obligation to act fairly and honestly with clients.

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Duplication on Conflicts of interest:
Our members must identify, address and disclose conflicts of interest as per Rule 42 of the IIROC Rulebook. Each firm must develop and maintain written policies and procedures to identify, avoid, disclose and address material conflict of interest situations.

Duplication on Know Your Client (KYC):
Our members must comply with KYC requirements which are more stringent than the Proposed Rules. For example, the current requirements regarding anti-money laundering and anti-terrorist financing are more stringent than the proposed CSA requirements.

Furthermore, the Proposed Rules define different types of clients: Derivatives Parties and Eligible Derivatives Parties. These new definitions further complicate the derivatives landscape. We believe that the definition of Eligible Derivatives Parties should be the same as Permitted Client. In particular, we believe the definition should include managed accounts.

Duplication on Suitability:
Our members must assess suitability. IIROC Rule 1300 "*Supervision of Clients*" details the suitability obligations of our members. The proposed CSA requirements in Section 12, such as suitability regarding instructions received from counterparties, are too broad and should not be applicable to IIROC-regulated firms.

Duplication on Referral:
Our members must disclose business or commission referral arrangements they enter into with third parties to their clients to ensure transparency.

Duplication on Fair Terms/ Best Execution:
Our members must provide best execution to clients and have the general obligation to act fairly and honestly with clients. For example, members must comply with National Instrument 23-101 regarding Trading Rules.

Duplication on Mandatory Disclosures:
Our members must provide mandatory disclosures on many topics to their clients. We fail to see how the new disclosure requirements in the proposal, which are extremely burdensome, will further protect investors.

Duplication on Safekeeping:
Our members must comply with safekeeping and segregation requirements. Rule 2600 "*Internal Control Policy Statements*" details the current requirements.

Duplication on Books and Records:
Our members must maintain accurate books and records which must be retained and made available for audit.

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Duplication on Complaint Handling:
Our members must comply with stringent complaint handling procedures, including the required filings through IIROC's Complaints and Settlement Reporting System (the ComSet system).

Duplication on Compliance/Risk Management and the Role of the Chief Compliance Officer:
Our members must ensure that compliance and risk management functions are accurately performed for all business activities and that the compliance oversight functions are independent of the business functions. Furthermore, Trading Supervisors are currently in place at our member firms.

The Proposed Rules make mandatory a new senior derivatives manager role. The manager would certify that the firm's derivatives business unit is in material compliance with the law. We believe that this new role, similar to what currently exists in the United Kingdom and Hong Kong, should not be applied to the Canadian environment. This new requirement would create an unwanted oversight separation between business units as well as a blurred line between business functions and compliance oversight functions which should be independent. We also believe that the proposed responsibilities set a different standard than what is required of a Chief Compliance Officer regarding Equity trading. We note that such a position does not and should not exist in this space.

Impact of Regulatory Overlap: High Cost for Clients

These proposed "duplicative" rules, often similar but rarely identical, would not better protect the investing public.

Furthermore, these new proposed requirements would potentially increase the trading cost for the investor. To implement these new rules, our members would need to modify their written policies and their operational procedures, all without a true benefit to clients. The cost incurred by our members to comply to these new rules would likely be passed on to the client.

Exemptions and Appendix B

Since IIROC-regulated dealers are already complying with extensive rules and regulations and because the Proposed Rules are mostly overlapping the current rules and regulations, we believe that IIROC-regulated dealers should be exempt from adhering to the Proposed Rules. Our members and their Canadian Financial Institution affiliates already meet equivalent regulatory requirements and therefore should not be required to comply with National Instrument 93-101.

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Furthermore, National Instrument 93-101 indicates that, to the extent that there is a substantially similar provision in the IIROC Rules, IIROC members will not be required to meet the requirements:

> "*A derivatives dealer that is registered as an investment dealer and that is a member of the Investment Industry Regulatory Organization of Canada is exempt from the requirements set out in Appendix B if the derivatives dealer complies with the corresponding conduct and other regulatory requirements of that organization in connection with the transaction or other activity*."

We believe that, subject to reviewing Appendix B, IIROC members will not be required to comply with the requirements. IIAC would be happy to work with IIROC and CSA Staff to review Appendix B.

Conclusion

The IIAC and its members strongly believe that IIROC-regulated dealers should be exempt from the application of National Instrument 93-101.

We would also like to mention that we find the Canadian Market Infrastructure Committee (CMIC) comment letter on the Proposed National Instrument to be extremely detailed and thorough. CMIC has performed an exhaustive analysis of the Proposed Rules, with which we agree, and we would like to refer you to their letter.

Please note that the IIAC and its Members, as always, remain available for further consultations.

Yours sincerely,

Annie Sinigagliese
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September 1, 2017

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Re: Proposed National Instrument 93-101 – Derivatives: Business Conduct Rules

Dear Me Beaudoin and Ms. Knakowski:

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The Canadian Bankers Association (CBA)[1] appreciates the opportunity to comment on the proposed business conduct rules. Before delving into the details of the proposed rules, we would reiterate comments provided in our previous submissions on over-the-counter (OTC) derivatives reforms regarding the jurisdictional division of powers in Canada as applied to banks.[2] We believe that the single set of principle-based federal rules administered by the Office of the Superintendent of Financial Institutions (OSFI) as banks' primary regulator has performed well and should be maintained on a going forward basis.

With respect to the proposed rules themselves, we would note that the business conduct framework as drafted highlights the challenges and concerns that are raised in applying a second set of prescriptive OTC derivatives rules to bank activities. In terms of detailed commentary in support of this point, we reference and endorse the submission provided by the Canadian Market Infrastructure Committee (CMIC) on the proposed rules. In particular, as discussed in further detail below, the CMIC submission details how the proposed rules are duplicative of existing requirements, unnecessary from a public policy perspective, impose significant costs, and would confer limited benefits from a broader public policy perspective.

Based on these considerations, we support CMIC's recommendation for a delay in the implementation of the rules until a comprehensive regulatory assessment can be completed. For banks in particular, we believe that in light of the issues identified in the CMIC submission, and the jurisdictional considerations noted above, a full exemption should be provided for banks from the proposed rules.

Key Points Raised in the CMIC Submission

The CMIC submission assesses the proposed rationale for the rules, includes a detailed gap analysis on whether the rules are needed, and documents the extensive costs involved in moving forward with the new framework. We would highlight the following key points from the submission from a bank perspective:

A. OTC Derivatives are not Securities

The CMIC submission makes the critically important distinction between a security and an OTC derivatives product:

> An OTC derivatives transaction is a bilateral, privately negotiated transaction where two parties are acting as principal and, generally speaking, both parties have obligations to each other during the term of the transaction which compels good practices. This may be contrasted with a securities transaction where one party offers an investment to a potential investor, the sale of which is effected by an intermediary. The investor does not have any further obligations to the issuer of the security. In the case of securities markets, there is perceived to be an informational imbalance between issuers and investors, which raises the need for protection of the investor by requiring prospectus-level disclosure in public offerings and certain disclosure in private offerings. In OTC derivatives markets,

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[1] The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

[2] See for example, the June, 17, 2013 letter from the CBA on the Proposed Derivatives Registration Regime for Federally-Regulated Banks http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20130617_91-407_canbankersass.pdf

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transactions are primarily used by individuals and corporations to hedge risks and accordingly, they are not primarily investment products but risk management products that have substantially different financial profiles, i.e. loss of principal vs. mark-to-market exposure. In addition, in most cases, the perceived informational imbalance that exists in the securities markets is not present in the OTC derivatives markets. Further, in the OTC derivatives markets, transactions are governed by internationally agreed ISDA documentation that, for the most part, is governed by New York law or English law, whereas securities transactions are not.

As noted in the CMIC submission, OTC derivatives are risk management products, generally involving large sophisticated investors where retail securities market protections are not a concern. As risk management products, rather than securities, the federal regulatory framework already appropriately imposes a wide range of principle-based requirements on banks involved in these markets that fully respond to the types of risk involved (see below for additional detail).

B. Duplication of Requirements

Related to the point above, the CMIC submission emphasizes that the proposed rules duplicate existing regulatory requirements, including, in the case of banks, a comprehensive set of federal rules:

> One of the principles under the [Ontario] Regulatory Policy[3] is that duplication of regulation should be minimized, where appropriate. As noted above, it is CMIC's view that the Proposed Rules significantly overlap with existing rules that are operating effectively and, in many cases, in a different manner. As a result, we do not believe the Proposed Rules are necessary given the effectiveness of existing regulations.

In the context of banks, an extensive set of largely principle-based regulatory requirements have already been developed and tailored to specifically respond to bank involvement in the OTC derivatives markets. This includes, among other things, the following requirements: OSFI Guideline B-7 on Derivatives Sound Practices; OSFI Guideline D-6 on Derivatives Disclosure; OSFI Guideline E-13 on Regulatory Compliance Management; OSFI Guideline B-1 on the Prudent Person Approach; OSFI Guideline B-2 on Large Exposure Limits; the OSFI Corporate Governance Guideline; the OSFI Supervisory Framework; the *Competition Act*; the *Bank Act*; FCAC Guidance CG-12 on Internal Dispute Resolution; and FCAC oversight of voluntary codes of conduct.

C. Proposed Rule is Unnecessary

As outlined in the CMIC submission, the public policy rationale for the rule is unclear:

> Another principle of the Ontario Regulatory Policy is that proposed regulations must respond to a clearly identified need for regulation. While other international jurisdictions have imposed business conduct rules for OTC derivatives, it is CMIC's view that a robust public policy justification has not yet been presented that these separate rules are necessary in Canada.

[3] Ontario Regulatory Registry, Ontario Regulatory Policy, available at http://www.ontariocanada.com/registry/downloads/Ontario%20Regulatory%20Policy.pdf.

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In addition, CMIC notes that market conduct was not listed as one of Canada's G-20 commitments. To our knowledge, Canadian regulators have not presented clear evidence that it is necessary for these business conduct rules to apply in particular to such a broad range of market participants.

Furthermore, in a Canadian context, the CMIC submission emphasizes that market participants like banks are generally large and highly sophisticated and therefore not in need of the types of protections proposed under the rules:

> It is not clear that market participants, and in particular, "large market participants" are in need of further protection other than that already afforded to them under existing regulation. Further, the analysis provides that the Proposed Rules "fills a regulatory gap" for certain derivatives firms that are not subject to business conduct regulation and oversight. While that may be the case for some market participants, it is CMIC's view that firms representing the overwhelming majority of OTC derivatives market participants, i.e. domestic and foreign banks and swap dealers, are already subject to business conduct regulation and oversight, either through prudential regulators or under foreign business conduct rules.

D. Significant Costs Imposed

Finally, the CMIC submission documents the extensive costs associated with the proposed rules, including the difficult challenges associated with attempting to engage in further client outreach to encourage compliance with the new rules (e.g. efforts to obtain additional representations from clients already facing a significant degree of regulatory fatigue in this market, particularly for clients outside of Canada). As CMIC notes:

> Non-Canadian derivatives firms are increasingly weighing the burden of complying with Canadian-specific regulations in deciding to continue transacting with Canadian counterparties. While the "costs" section of the analysis recognizes the possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Rules, it cites the fact that substituted compliance will significantly reduce such compliance costs. CMIC submits that a significant reduction of such compliance costs is unlikely because foreign derivatives firms will need to spend the time and money analyzing the Canadian rules to implement and ensure compliance with the provisions for which substituted compliance has not been granted. This may dissuade them from transacting with Canadian market participants... .

Beyond CMIC, we would note that other organizations, including the International Swaps and Derivatives Association (ISDA), are raising significant concerns about the impact of the proposed rules on the Canadian market, including the willingness of foreign dealers to continue to transact with Canadian counterparties:

> We suggest the CSA introduce a third tier for transactions between dealers (both foreign and domestic) which would be exempt from all requirements in the Proposed Rule (effectively an outright exemption for the inter-dealer market). Such an approach, for example, would allow foreign dealers to transact with Canadian dealers (including Canadian banks) without having to address the Proposed Rule. Absent such a "third tier", foreign dealers that only participate in the inter-dealer market may be reluctant to continue to transact with Canadian dealers due to the increased compliance burden. This could

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result in less liquidity being available in the Canadian markets. We submit that even the limited requirements applicable to EDPs under the Proposed Rule are not necessary in the context of inter-dealer activity and that therefore this third tier is appropriate.

We would also ask the CSA to consider the possible implications of imposing the senior derivatives manager regime in the context of cross-border activities. If derivatives firms that are not subject to such a regime in their home jurisdiction are required under the Proposed Rule to implement this framework just for Canadian local clients, this requirement could act as a disincentive to continuing to provide services to Canadian clients. While ISDA supports a robust customer protection regime for Canadian derivatives clients, we caution against imposing requirements that are so out of step with other major jurisdictions that they could result in less cross-border liquidity and advisory expertise being made available for Canadian clients.

In summary, the impacts of the proposed rules are wide ranging:

- *clients*: increased costs; challenges with regulatory fatigue; potential loss of access to products/services;
- *domestic Canadian market participants*: the rules could result in higher costs and the erosion of the competitive position of domestic market participants;
- *market liquidity*: there is a significant risk that foreign market participants may be incented to avoid dealing with Canadian market participants, leading to a loss of market liquidity;
- *increased risks*: an erosion of market participants and liquidity and the development of a fragmented, prescriptive and highly complex regulatory framework could create challenges for the monitoring and management of risks on an ongoing basis.

Based on the foregoing, we would reiterate our belief that the existing federal regulatory framework for banks is functioning well and that the proposed new rules could compromise the effectiveness of not only this framework, but of the broader OTC derivatives market in Canada. We therefore request that an express exemption be included in the rules for banks that are already subject to an appropriate degree of federal regulatory oversight through OSFI. At minimum, a broad cost-benefit analysis of the rules is needed before a determination can be made if the rules should go ahead.

Specific Comments

With respect to the specific issues identified with the proposed rules, we would underscore in particular the following detailed recommendations outlined in the CMIC submission:

Senior Derivatives Managers

As set out in the CMIC submission, the proposed rules regarding senior derivatives managers differ significantly from the existing compliance regime structure for federally regulated financial institutions. OSFI Guideline E-13 *Regulatory Compliance Management* focuses on the key role of the Chief Compliance Officer (CCO) in overseeing monitoring and reporting on compliance matters. Further, OSFI Guideline E-21 *Operational Risk Management* sets out the "three lines of defence" approach to compliance as the preferred approach, which specifies the business line as the first line of defence, objective oversight activity on an enterprise basis as the second line of defence, and the internal audit function as the third line of defence. As the CMIC submission notes, the proposed regime is inconsistent with this existing structure and would result in oversight fragmentation and a serious risk of not being able to determine who is responsible for compliance.

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Finally, as detailed in the CMIC submission, the UK and Hong Kong senior derivatives manager regimes originate from very different conditions that are not present in the Canadian context.

Definition of Eligible Derivatives Party

We reiterate the commentary in the CMIC letter regarding the definition of "eligible derivatives party". In particular, we endorse CMIC's recommendation that the definition of "eligible derivatives party" be revised to:

- lower the threshold in paragraph (m) of the definition for a non-individual to $10 million;
- remove the knowledge and experience requirements under paragraphs (m) and (n);
- add a hedger category; and
- add "permitted client" as defined under National Instrument 31-103 as an additional category.

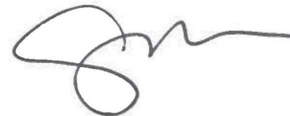
Inter-dealer Exemption

In line with CMIC's and ISDA's recommendation, we encourage the regulators to exempt the inter-dealer market from the proposed rules. Under this three-tiered structure, instead of the proposed two-tiered structure, participants in the inter-dealer market would be exempt from all business conduct rules where dealers are transacting with each other or with a clearing agency. As CMIC notes in its submission, "derivatives dealers have been comfortable transacting with each other under existing prudential rules or other laws (such as anti-money laundering laws and anti-terrorist financing laws) and, in CMIC's view, do not need the added "protection" of the Proposed Rules."

****

Thank you for considering our comments on the proposed business conduct rules. We would be pleased to answer any questions you may have.

Sincerely,



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VIA ELECTRONIC MAIL

September 1, 2017

Alberta Securities Commission
Authorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Commission
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Anne-Marie Beaudoin
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Dear Sirs/Madams:

Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy

The International Energy Credit Association ("**IECA**") hereby submits the comments contained in this letter on behalf of its members in response to the solicitation for comments made by the Canadian Securities Administrators ("**CSA**") in respect of the following published documents:

- Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the "**Proposed Rule**"); and
- Proposed Companion Policy 93-101 Proposed CP *Derivatives: Business Conduct* (the "**Proposed CP**").

(collectively, the **"Proposed BC Instrument"**)

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I. INTRODUCTION

The IECA is not a lobbying group. Rather, the IECA is an association of several hundred energy company credit management, contract administration and legal professionals grappling with credit-related issues in the energy industry.

The IECA seeks to protect the rights and advance the interests of the commercial energy end-user community that makes up its membership. The IECA membership includes many small to large energy companies, few of whom are likely to be deemed derivatives dealers in Canada, but all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that Canadian businesses and consumers require for our economy and our livelihood.

Correspondence with respect to this comment letter and questions should be directed to the following individuals:

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II. COMMENTS OF THE IECA

On April 18, 2013 the CSA published the CSA Consultation Paper 91-407 *Derivatives: Registration* which provided an overview of the CSA's proposal for the regulation of key derivatives market participants through the implementation of a registration regime and a compliance system/internal business conduct regime. The CSA has since decided to split the regulation in this space into two separate regulations: one national instrument for business conduct and one national instrument for registration.

On April 4, 2017, the CSA published the Proposed BC Instrument for comment. In the CSA Notice and Request for Comment publishing the Proposed BC Instrument, the CSA indicated that they were in the process of developing a proposed registration regime for derivatives dealers, derivatives advisers and potentially other derivatives market participants. The CSA expected to publish the Proposed National Instrument 93-102 *Derivatives: Registration* and a related companion policy ("**Proposed Registration Instrument**") for comment during the same consultation period as the Proposed BC Instrument. In fact, the CSA extended the comment period for the Proposed BC Instrument for 150 days in order to allow market participants and other stakeholders an opportunity to consider both proposed instruments before the comment period expired.

On June 15, 2017, the CSA published CSA Staff Notice 93-301 which stated that the comment periods for the Proposed BC Instrument and the Proposed Registration Instrument would not overlap. The IECA believes that this is unfortunate because the concept of "derivatives dealer" is key to whether or not a party is subject to the Proposed Rule. Further, the IECA hopes that the Proposed Registration Instrument will make clear that any exemptions to derivatives dealer registration can be relied upon to avoid being designated a derivatives dealer in the Proposed Rule and that the Proposed Registration Instrument will apply not only to the Proposed BC Instrument but also to any other derivatives instruments/rules that the CSA has already enacted or proposes to enact in the future. The IECA respectfully requests that the CSA further extends the comment period for the Proposed BC Instrument so that there is overlap with the comment period for the Proposed Registration Instrument. The IECA strongly believes that the Proposed BC Instrument and the Proposed Registration Instrument should be moved forward in unison.

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Alternatively, the IECA respectfully requests the market participants be given the opportunity to submit supplementary comments on the Proposed BC Instrument (including comments on specific questions not discussed in this letter) during the comment period for the Proposed Registration Instrument.

The IECA would like to express its general support of the Comment Letter from Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, to the Canadian Securities Administrators dated August 15, 2017 (the "**CCE Letter**"). Throughout this letter the IECA will refer to specific sections of the CCE Letter in support of the comments contained herein.

A. DEFINITIONS

Although the CSA did not specifically put forward a question regarding defined terms, generally, the IECA would suggest that certain terms used throughout the derivatives regulations in Canada (for example, "derivatives dealer") could benefit from standardization into a consolidated instrument like National Instrument 14-101 *Definitions*. By way of example, the term "derivatives dealers" is defined in the Proposed Rule, but the definition is different from the reporting rules that have been implemented across Canada in that it adds another class of derivatives dealer. The IECA would propose a more streamlined process whereby commonly used terms (like derivatives dealer) are consolidated across Canada in one instrument for ease of reference and to reduce unnecessary confusion.

B. DEFINITION OF "ELIGIBLE DERIVATIVES PARTY" (CSA QUESTION #1)

Respectfully, the IECA does not believe that the definition of EDP as set out in the Proposed BC Instrument is the appropriate definition for this term. The IECA believes that the CSA should consider amending the definition of EDP, as suggested below.

1. Harmonization and Revision

The IECA believes that the definition of EDP should be aligned with existing derivatives regulation definitions. Specifically, the IECA suggests that the definition of EDP should be consistent with the concepts of "**qualified party**" under various Provincial Exemption Orders (like Alberta Securities Commission Blanket Order 91-507 – *Over-the-Counter Trades in Derivatives* ("**BO 91-507**")); and the British Columbia Securities Commission Blanket Order 91-501 (BC), *Over-The-Counter Derivatives 91-501(BC)*; "**accredited counterparty**" under the *Derivatives Act* (Quebec); and "**eligible contract participant**" ("**ECP**") under various U.S. Commodity Futures Trading Commission ("**CFTC**") Rules.

The term ECP, as used by the CFTC, is defined in Section 1a(18)(a)(v) of the US Commodity Exchange Act (in part) as:

> (v) a corporation, partnership, proprietorship, organization, trust, or other entity – (I) that has total assets exceeding $10,000,000; (II) the obligations of which under an agreement, contract, or transaction are guaranteed or otherwise supported by a letter of credit or keepwell, support, or other agreement by an entity described in subclause (I) …; or (III) that (aa) has a net worth exceeding $1,000,000; and (bb) enters into an agreement, contract, or transaction in connection with the conduct of the entity's business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity's business; (emphasis added.)

The ECP definition is significant because it allows Canadian market participants that satisfy the ECP definition to have access to the U.S. derivatives markets, which are larger and more liquid than Canadian derivatives markets. In order to harmonize the Proposed Rule with ECP definition, the IECA respectfully

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requests that the CSA revise the $25 million net asset threshold contemplated in the current definition of EDP to a lesser threshold of $10 million total assets.

The IECA also suggests that lack of harmonization and/or substituted compliance among the EDP definition and the three definitions described above could have the effect of driving foreign swap dealers out of the Canadian market, since their cost of compliance would increase by their having to establish additional, if not separate, compliance measures just to meet the Canadian requirements. An unintended consequence of the flight of derivatives participants from the Canadian market could be increased liquidity risk. Having fewer swap dealer-suppliers concentrates performance and liquidity risk in those fewer derivative dealers, which creates a less liquid market (i.e. less flexibility and less ability to react and absorb market shocks and default events, because there are fewer participants in the market to spread the risk around). Finally, without harmonization and/or substituted compliance with respect to core concepts like the EDP definition, market participants in Canada will not be able to utilize platforms that have already been developed to exchange information with other market participants (e.g. Markit).

The IECA respectfully submits that there is no reason to create another class of entities to which the Proposed Rule would apply. The currently existing definition of “qualified parties” and “accredited counterparties” already capture those counterparties who do not require the full set of protections afforded to retail customers or investors, either because they may reasonably be considered sophisticated or because they have sufficient financial resources to purchase professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm. However, if the CSA is reluctant to take up the suggestion of the IECA in this respect, the IECA proposes that, at a minimum, the EDP definition should include the qualifications described in subsections (p)(q)(s)(t)(u)(v)(w) & (x) of the definition of “qualified party” in BO 91-507, as set forth in Schedule A to this letter.

The proposed revision in Schedule A also contemplates a revision to the $25 million net asset threshold to the lesser threshold of $10 million total assets, thus making the proposed definition of EDP for Canadian markets consistent with the definition of ECP for US markets.

2. Guarantees

The EDP definition should also be amended to allow an entity to qualify as an EDP if its obligations are guaranteed by an entity that otherwise qualifies as an EDP. A guarantor who meets the criteria of an EDP would be sophisticated or otherwise have the financial resources to protect itself in its role as a guarantor. As such, the protective intent of the Proposed Rule is unnecessary for such guaranteed counterparties. As noted in the CCE Letter (page 8):

> In many circumstances, a commercial energy company will have project entities created to house a particular project, like a wind farm or central hedging entities that face the market on behalf of affiliates. These entities may not have the $25 million in net assets needed to qualify as an EDP, but, in many cases, receive credit support from an affiliate that is an EDP.

Existing derivatives regulation in Canada, like BO 91-507, permit a market participant to be considered an EDP if its obligations under the derivatives that are being traded are fully guaranteed by one or more “qualified parties” or “accredited counterparties”. Further, both the European Union’s Markets in Financial Instruments Directive 2004/39/EC (“**MiFID**”) and CFTC Rules allows the guarantee of an ECP in the U.S. or an eligible counterparty or Professional Client (“**EC**” or “**PC**”) in the European Union to be deemed an ECP or an EC or PC if it has a guarantee or a payment undertaking obligation from a company that is an ECP or an EC or PC. The IECA respectfully suggests that harmonization with other derivatives

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regulations (in Canada and internationally) to allow an entity to qualify as an EDP if its obligations are guaranteed by an entity that otherwise qualifies as an EDP will prevent undue compliance costs incurred by market participants and also prevent the flight of participants from the market.

3. Reliance on Representations and Warranties

The Proposed CP indicates that a derivatives dealer must take certain steps to determine whether a derivatives party is an EDP before transacting with or advising them. The Proposed CP goes on to state that:

> In determining whether the person or company that it transacts with or advises is an eligible derivatives party, the derivatives firm may rely on factual representations made in writing by the derivatives party, unless a reasonable person would have grounds to believe that such statements are false or it is otherwise unreasonable to rely on the representation. The criteria for determining whether a derivatives party is an eligible derivatives party are to be applied at the time a particular derivative is first entered into. A derivatives firm is not required to ensure that the derivatives party continues to be an eligible derivatives party during the life of the particular derivative but must consider the derivative party's eligible derivatives party status before entering into a new transaction with that derivatives party.

As with other representations and warranties given between counterparties to derivatives transactions, the IECA respectfully suggests that representations as to requisite knowledge and experience of a counterparty should be allowed to be given in Master Agreements or protocols amending them. IECA would request specific language to be included in the Proposed CP to that effect.

Further, a counterparty should be able to rely on representations as to requisite knowledge and experience of a counterparty unless a reasonable person would have grounds to believe that such statements are false or it is otherwise unreasonable to rely on the representation. No active investigation should be required on behalf of the counterparty relying on these representations. The IECA wholly concurs with the CCE Letter (pages 8-9) on this issue.

Finally, the IECA respectfully submits that a market participant engaged in commodity hedging should have the ability to represent and warrant their qualifications to assess risks and to "opt-in" to being treated as an EDP even if they don't meet the asset thresholds.

4. Exemptions – Application of Proposed Rule

(a) End-User

Section 39 of the Proposed Rule sets out an exemption for certain derivatives end-users from the Requirements of the Proposed Rule, as follows:

> A person or company is exempt from the requirements of this Instrument if each of the following applies:
>
> (a) the person or company does not solicit, or otherwise transact in a derivative with, for or on behalf of, a person or company that is not an eligible derivatives party;
>
> (b) the person or company does not, in respect of transactions in derivatives, advise other persons or companies that are not eligible derivatives parties, other than general advice that is provided in accordance with the conditions of section 43 [Advising generally];

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(c) the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;

(d) the person or company does not regularly facilitate or otherwise intermediate transactions in derivatives for another person or company;

(e) the person or company does not facilitate the clearing of a transaction in a derivative through the facilities of a clearing agency for another person or company, other than for an affiliated entity.

The current exemption prescribes that a person cannot transact with non-EDP's in order to qualify for the end-user exemption. The IECA suggests that it would be overly onerous to require an otherwise exempt market participant to comply with the Proposed Rule simply because they transact with a non-EDP. Given the plethora of business conduct requirements set out in the Proposed Rule, many market participants will seek to utilize the end-user exemption. In fact, market participants may cease transacting with non-EDP's so that they can fit the end-user exemption. This will create market risk in two separate ways: (i) non-EDP's will have fewer counterparties with which to enter into transactions to hedge their business risk; and (ii) if there are fewer counterparties willing to transact, market liquidity will decrease.

Subsection (c) prescribes that a party cannot qualify for the end-user exemption if a person regularly quotes prices at which they would be willing to transact in a derivative. The CSA has further prescribed, in the Proposed CP, that an indicia of being a "derivatives dealer" is quoting prices. As the IECA will discuss in more detail below (see page 10 in response to CSA Question #5), regularly providing quotes is not necessarily an indication that a person or company is a derivatives dealer. The end-user exemption should be available to entities who regularly quote prices, as long as they aren't otherwise market-makers.

(b) De minimis

The IECA strongly believes that there should be a notional value-based de minimis exception to being classified as a derivatives dealer. The IECA notes and supports the commentary contained in the White Paper "The Need for a De Minimis Exception from Registration as Derivatives Dealer in Canadian Provinces and Proposed Approaches for Implementation" (the "**White Paper**") which is attached as Exhibit I to the CCE Letter. The White Paper speaks effectively about market participants exiting the derivatives markets, in the absence of a *de minimis* dealing threshold, and the corresponding negative market impacts, including risk concentration and decreased liquidity.

C. KNOWLEDGE AND EXPERTISE REQUIREMENTS IN CLAUSES (M) AND (N) OF THE DEFINITION OF "ELIGIBLE DERIVATIVES PARTY" (CSA QUESTION #3)

As currently contemplated in the Proposed Rule, clauses (m) and (n) of the definition of EDP read as follows:

(m) a person or company, other than an individual,

(i) that has represented in writing that it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives, the suitability of the derivatives for that person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf, and

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(ii) that has net assets of at least $25 million as shown on its most recently prepared financial statements

(n) an individual

(i) who has represented in writing that he or she has the requisite knowledge and experience to evaluate the information provided to the individual about derivatives, the suitability of the derivatives for that individual, and the characteristics of the derivatives to be transacted on the individual's behalf, and

(ii) that beneficially owns financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, that have an aggregate realizable value before tax but net of any related liabilities of at least $5 million

Requiring EDP representations and/or determinations at a product-type level is impractical for both the derivatives dealer and the EDP.

From the perspective of a derivatives dealer, it would require the derivatives dealer to regularly confirm that representations and warranties it received from its EDP counterparties remained up-to-date as far as product-types were concerned. Similarly, from the EDP's perspective, they would have to regularly give new representations and warranties as their knowledge and experience with product-types changed over time. This creates unnecessary administrative burden for little practical protection.

A party that is sophisticated enough to otherwise qualify as an EDP should be sophisticated enough to know what product-types it was comfortable, or competent, to transact. It should also have its own internal policies and procedures regulating its derivatives activities, including allowed product-types, position limits, and requisite market knowledge and experience among its derivatives trading staff. There should remain some responsibility for one's own actions and market conduct on the part of eligible derivatives parties and derivatives dealers shouldn't be burdened with having to police that EDPs have requisite knowledge and experience with specific derivative product-types.

In addition, derivatives dealers should be able to rely on representations and warranties received from their EDP counterparties without further investigation unless the dealer actually has knowledge that would make it question the accuracy/truthfulness of such representation or warranty. The IECA respectfully recommends that the Proposed Rule and the Proposed CP make clear that a derivatives dealer or derivatives adviser be able to treat a derivatives party as an EDP for all purposes.

Finally, although the CSA did not specifically put forward a question regarding the asset threshold test in subsection (m) of the EDP definition, the IECA would respectfully request a revision to such subsection. The IECA recommends that subsection (m) of EDP definition be revised such that (i) the asset threshold test: (a) should apply to gross assets and not net assets, and (b) be reduced from $25 million to $10 million; and (ii) specifically allow for the threshold to be met through guarantees (i.e. an EDP includes a person, other than an individual, whose obligations are guaranteed by a person who is an EDP).

D. TWO-TIERED APPROACH TO REQUIREMENTS: ELIGIBLE DERIVATIVES PARTIES VS. ALL DERIVATIVES PARTIES (CSA QUESTION #4)

The Proposed Rule prescribes a two-tiered approach to investor/customer protection. A derivatives firm[1] has certain obligations that apply in all cases when dealing with or advising a derivatives party[2]

[1] The CSA refers to derivatives dealers and advisors collectively as a "**derivatives firm**".

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regardless of the level of sophistication or financial resources of the derivatives party. Other obligations contained in the Proposed Rule do not apply if the derivatives firm is dealing with or advising a derivatives party that is an EDP.

The two-tiered approach to conduct requirements (distinguishing between eligible derivatives parties and derivatives parties) is logical and appropriate given the differing levels of market sophistication between the two categories of market participant. However, in addition to revising the definition of EDP (as discussed above), the IECA respectfully requests that the CSA make reference to the MiFID on the two-tiered approach issue.

MiFID provides for two main categories of "client": (i) retail; and (ii) professional, with a separate and distinct third category for a limited range of businesses: eligible counterparty. MiFID attaches different regulatory protections to each of these categories, with the result that those falling within the retail category – the less experienced, knowledgeable and sophisticated investors – will be afforded a higher level of protection than that afforded to investors in the professional or eligible counterparty category. It would be beneficial to the market if the CSA allows an entity that may not fit the EDP definition to be treated as such upon request (i.e. the derivatives dealer could forward a questionnaire in order to establish whether the entity possesses sufficient experience, knowledge and expertise to enable him/her to make his/her own trading decisions and properly assess the risks that such trade incurs).

E. BUSINESS TRIGGER GUIDANCE (CSA QUESTION #5)

The Proposed Rule applies to "derivatives dealers" (those in the business of trading over-the-counter ("**OTC**") derivatives), and "derivatives advisors" (those in the business of advising in OTC derivatives), regardless of whether they are registered or exempt from the requirement to register as a dealer or advisor in any given jurisdiction. Specifically, in the Proposed Rule "derivatives dealer" means:

(a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of trading in derivatives as principal or agent, and

(b) any other person or company required to be registered as a derivatives dealer under the securities legislation of a jurisdiction of Canada;

In determining whether a person is in the business of trading or advising in derivatives, the CSA indicates in Part 1 of the Proposed CP that a number of factors should be considered, including if the person is:

- quoting prices or acting as a market maker;
- directly or indirectly carrying on derivatives trading or advising activity with repetition, regularity or continuity;
- facilitating or intermediating transactions;
- transacting with the intention of being compensated;
- directly or indirectly soliciting in relation to derivatives transactions;
- engaging in activities similar to a derivatives dealer or derivatives advisor;
- an "adviser" in Manitoba as defined in the Commodity Futures Act (Manitoba);
- an "adviser" in Ontario as defined by the Commodity Futures Act (Ontario); or

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[2] "**derivatives party**" means: (a) in the case of a derivatives dealer a person for which the derivatives dealer acts or proposed to act as agent in relation to a transaction in a derivative or a person that is or is proposed to be a party to a derivative where the derivatives dealer is the counterparty; and (b) in the case of a derivatives adviser, a person to which the adviser provides or proposes to provide advice in relation to derivatives.

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- an "adviser" in Québec as defined by the Securities Act (Québec).

In the Proposed CP, the CSA also points out that it does not consider that all of the factors discussed above are exhaustive, nor do they necessarily carry the same weight. Triggering one factor will not be determinative. A person should consider their activities holistically in determining whether they would be considered a derivatives dealer or derivatives advisor; ad hoc or isolated instances of activities may not necessarily result in a person being a derivatives dealer or derivatives advisor.

The CSA has asked for focused comments from market participants and other stakeholders on the aspect of the business trigger related to quoting prices or acting as a market maker. Part 1 of the Proposed CP (General Comments) states:

> *Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

Section 39(c) of the Proposed Rule reads as follows:

> A person or company is exempt from the requirements of this Instrument if each of the following applies:
> …
> (c) the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party;

1. Quoting prices or Acting as a Market Maker

Part 1 of the Proposed CP (quoting prices or acting as a market maker) and Section 39(c) of the Proposed Rule (exemptions for certain derivatives end-users) do not appropriately describe the situation in which a person or company should be considered a derivatives dealer for two reasons: (i) regularly providing quotes is not necessarily an indication that a person or company is a derivatives dealer; and (ii) end-users regularly quote prices in their hedging business activities.

Although the Proposed CP suggests that quoting prices or acting as a market maker may not be determinative of whether or not a market participant would be considered a derivatives dealer for the purpose of the Proposed Rule, the IECA has concerns with the assumptions made in the Proposed CP in respect of regularly quoting prices as indicia of being a derivatives dealer.

Specifically, the IECA respectfully challenges the assumption set out by the CSA in the Proposed CP that it would not be reasonable for a company who regularly quotes prices on derivatives to other derivatives parties to claim that it is an end-user hedging business activities. The IECA notes and supports the comments made in the CCE Letter (pages 3-4) which provides excellent industry-specific examples illustrating why such assumption is false. Further, the CCE Letter (page 4) also provides appropriate suggestions regarding how the CSA should revise its guidance with respect to the provision of quotes and what activities should constitute market making. The IECA supports these recommendations.

If the CSA is reluctant to take up the recommendations set out in the CCE Letter, the IECA would respectfully propose that the CSA consider amending Section 39(c) to read as follows:

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> the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party ***that is not an eligible derivatives party***;

Adopting the suggested revision would better align the derivatives dealer business trigger guidance in the Proposed CP and the end-user exemption in Section 39 of the Proposed Rule with the two-tiered approach to business conduct requirements set out generally in the Proposed Instrument. In other words, routinely quoting prices to or offering to make a market with eligible derivatives parties should not attract the same level of business conduct requirements as engaging in those activities with non-eligible derivatives parties.

2. Self-Analysis – Derivatives Dealer

The IECA understands that its members will need to consider their activities holistically in order to determine whether or not they will be considered a derivatives dealer for the purposes of the Proposed Rule. However, without a clear, unambiguous definition of what a derivatives dealer is, there is concern that a company's analysis regarding their designation as a derivatives dealer may differ from the same analysis conducted by their Securities Regulator. The business trigger commentary does not make the determination any less ambiguous. As discussed above in response to the CSA Question #1, the IECA submits that various, but all reasonable, interpretations could be made upon which a company can conclude that it isn't a derivatives dealer. Therefore, it is critical that the guidance set out in the Proposed CP provides pragmatic business trigger indicia, especially in circumstances where end-users regularly quote prices in their hedging business activities.

Will the CSA establish a dispute resolution process or adjudicative body where such market participant can argue their case to support their self-assessment as a non-derivatives dealer? The consequences of non-compliance can be great if the regulator concludes differently. Market participants should have a due diligence defence to support their assessment to avoid fines or penalties.

F. SENIOR DERIVATIVES MANAGERS (CSA QUESTION #10)

The Proposed Rule requires derivatives firms to have policies and procedures in place that create a system of controls to manage risk and to ensure that the individuals at derivatives firms have the necessary training and expertise to meet the various compliance and record keeping obligations. Pursuant to the Proposed Rule, senior management in a derivatives firm has certain supervisory, management and reporting obligations. The CSA indicates in the Proposed Rule that "[t]hese requirements are intended to create accountability at the senior management level."

A senior derivatives manager is an individual that is responsible for (or head of) the derivatives activities of a particular business unit. The Proposed Rule requires that senior derivatives managers also be responsible for supervising the activities conducted in the organization that are directed towards ensuring compliance with applicable law, promoting compliance and to taking reasonable steps to prevent and address any non-compliance. Imposing these obligations on senior derivatives managers creates dual, and arguably competing, obligations of business and compliance.

The proposed senior management requirements set out in the Proposed Rule do not reflect existing best practice. Best practice prescribes that the compliance function of an organization always remains independent of the business function of an organization in order to mitigate inherent conflict of interest. It would be imprudent for market participants to modify their current compliance regimes in order to comply with the proposed senior management requirements set out in the Proposed Rule.

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Many IECA members currently utilize compliance best practice (separation of their compliance and business functions) to effectively manage risk within their respective organizations. The IECA wishes to provide an example of a compliance system that is typical of its membership and represents best practice in the industry. In this sample compliance system:

- accountability for the management of risk and compliance with applicable laws already exists at the Board level which is then delegated down to the corporation's audit, finance and risk committee;
- a separate risk group that is not engaged in derivative activities (part of the organization's corporate function) maintains, monitors and enforces compliance through approved risk policies and procedures including any delegation of authorities to individual transactors;
- reporting on compliance matters occurs consistently and regularly to management, with any material issues escalated to higher level risk committees and ultimately to the corporation's audit, finance and risk committee) on a quarterly basis; and
- material issues are also reported on a quarterly basis to the compliance law group by the risk group.

For these reasons, the IECA respectfully requests that proposed senior management requirements be removed from the Proposed Rule and that in its absence, market participants continue to adhere to their internal compliance best practices. In the alternative, the IECA respectfully requests that the proposed senior management requirements be amended in the Proposed Rule and the Proposed CP to reflect current industry best-practice.

G. RECORDKEEPING

Section 36 of the Proposed Rule contains certain recordkeeping obligations applicable to derivatives dealers. The Proposed CP indicates that:

> Section 36 imposes a general obligation on a derivatives firm to keep full and complete records relating to the derivatives firm's derivatives, transactions in derivatives, and all of its business activities relating to derivatives, trading in derivatives or advising in derivatives.

Although the CSA did not specifically put forward a question regarding the appropriateness of the recordkeeping requirements, the IECA respectfully submits that the recordkeeping obligations on derivatives dealers are too broad and should be limited to:

- records pertaining to the applicable standards of client obligations set out in Sections 10, 11 and 12 (as applicable);
- records required to demonstrate reliance on any exemption or exclusion in the Proposed Rule;
- records related to the negotiation, execution, amendments and termination of derivatives transactions.

Compliance with Section 36 of the Proposed Rule as currently drafted would be extremely expensive for derivatives firms. Those costs would, in turn, be passed on to other market participants.

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The CCE Letter (page 12) accurately describes the impact of the current Proposed Rule and Proposed CP, as follows:

> ...[T]he proposed recordkeeping standard goes beyond keeping records related to the execution and negotiation of trades. The standard could be read to cover all back office activities related to derivatives activity, which are largely mechanical in nature and the burden associated with keeping such records would not be offset by the minimal probative value to regulators in providing these records.

In particular, the IECA notes that the requirements to keep recordings of phone calls and records of instant messaging ("**IM**") with respect to commodity transactions are problematic. Phone line recordings record all conversations which occur when the phone is picked up. It would be extremely difficult and time consuming for market participants to effectively search those recordings each day and allocate portions of them to a specific derivatives transaction.

The IECA notes that different commodities trade differently (e.g. IMs are used instead of the telephone) and a phone may never be picked up. With respect to the requirement to keep an itemized record of post-transaction processing and events, the IECA notes that keeping IMs (and guaranteeing they have not been altered) is also difficult. Given that written confirmations are agreed between the counterparties within a few days of the trade, the value of the records related to IMs and phone calls are quite low.

The IECA respectfully requests that the CSA limit the recordkeeping obligations of derivatives dealers to those set out in the bullet points on page 12 of this letter. The IECA also supports the recommendation made in the CCE Letter (page 12) which requests that the CSA "...clarify that in the event such communication is made over the phone, that the recordkeeping requirement would be satisfied if a record of that communication was made...". In other words, a recording would not be required if a record of the phone communication otherwise exists in a different format.

III. CONCLUSION

The IECA appreciates the opportunity to table our members' comments and concerns to the CSA. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member.

Yours truly,

INTERNATIONAL ENERGY CREDIT ASSOCIATION

Courtney Burton
DENTONS CANADA LLP

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SCHEDULE A
REVISED DEFINITION OF EDP

"**eligible derivatives party**" means any of the following:

a) a Canadian financial institution;

b) the Business Development Bank of Canada incorporated under the Business Development Bank of Canada Act (Canada);

c) a subsidiary of a person or company referred to in paragraph (a) or (b), if the person or company owns all of the voting securities of the subsidiary, except the voting securities required by law to be owned by directors of the subsidiary;

d) a person or company registered under the securities legislation of a jurisdiction of Canada as at least one of the following:

   i. a derivatives dealer;

   ii. a derivatives adviser;

   iii. an adviser;

   iv. an investment dealer;

e) a pension fund that is regulated by either the federal Office of the Superintendent of Financial Institutions or a pension commission or similar regulatory authority of a jurisdiction of Canada or a wholly-owned subsidiary of such a pension fund;

f) an entity organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (e);

g) the Government of Canada or a jurisdiction of Canada, or any Crown corporation, agency or wholly-owned entity of the Government of Canada or a jurisdiction of Canada;

h) any national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction, or any agency of that government;

i) a municipality, public board or commission in Canada and a metropolitan community, school board, the Comité de gestion de la taxe scolaire de l'île de Montréal or an intermunicipal management board in Québec;

j) trust company or trust corporation registered or authorized to carry on business under the Trust and Loan Companies Act (Canada) or under comparable legislation in a jurisdiction of Canada or a foreign jurisdiction, acting on behalf of a managed derivatives account managed by the trust company or trust corporation, as the case may be;

k) a person or company acting on behalf of a managed account that is managed by the person or company, if the person or company is registered or authorized to carry on business as an adviser or a derivatives adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction;

l) an investment fund that is advised by an adviser registered or exempted from registration under securities or commodity futures legislation in Canada;

m) a person or company, other than an individual,

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i. that has represented in writing that it has the requisite knowledge and experience to evaluate the information provided to the person or company about derivatives, the suitability of the derivatives for that person or company, and the characteristics of the derivatives to be transacted on the person or company's behalf, and

ii. that has total assets of at least $10 million as shown on their most recently prepared annual financial statements or interim report;

n) an individual

i. who has represented in writing that he or she has the requisite knowledge and experience to evaluate the information provided to the individual about derivatives, the suitability of the derivatives for that individual, and the characteristics of the derivatives to be transacted on the individual's behalf, and

ii. that beneficially owns financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, that have an aggregate realizable value before tax but net of any related liabilities of at least $5 million;

o) a person or company that buys, sells, trades, produces, markets, brokers or otherwise uses a commodity in its business and that executes an over-the-counter trade in a derivative provided that a material component of the underlying interest of the derivative is any of the following:

i. a commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;

ii. a commodity, security or variable that directly or indirectly affects the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;

iii. a commodity, security or variable for which there is a high degree of correlation between the movement in its value and the movement in the value of the commodity that the person or company buys, sells, trades, produces, markets, brokers or otherwise uses in the ordinary course of its business;

iv. another derivative which is not listed for trading on an exchange, where a material component of the underlying interest of that other derivative is a commodity, security or variable referred to in any of subparagraphs (i) to (iii);

p) a person or company to which, with its affiliates, either of the following applies:

i. the person or company has executed one or more over-the-counter trades in derivatives with counterparties that are not its affiliates, provided that each of the following applies:

A. the trades had a total gross value of at least $1 billion (or its equivalent in another currency) in notional principal amount;

B. any of the derivatives relating to one of these trades was outstanding on any day within the 15 months prior to the trade;

ii. the person or company had on any day since the date that is 15 months prior to the trade total gross marked-to-market positions of at least $100 million (or its equivalent in another currency) aggregated across counterparties, in one or more over-the-counter trades in derivatives;

q) a person or company that is directly or indirectly wholly owned (not taking into account securities required by law to be held by directors) by one or more qualified parties;

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r) a person or company that directly or indirectly wholly owns (not taking into account securities required by law to be held by directors) a eligible derivatives party;

s) a person or company that is directly or indirectly wholly owned (not taking into account securities required by law to be held by directors) by a person or company referred to in paragraph (r);

t) a person or company directly or indirectly controlled by one or more eligible derivatives parties that are not individuals or investment funds; and/or

u) a person or company whose obligations under the derivative that is being traded are fully guaranteed by one or more eligible derivatives parties.

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September 1, 2017

DELIVERED VIA ELECTRONIC MAIL

Alberta Securities Commission
Authorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Commission
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintend of Securities
Superintendent of Securities, Department of Justice and Public Safety,
Prince Edward Island

(collectively called the "**Authorities**")

c/o
Me Anne-Marie Beaudoin
Corporate Secretary
Authorité des marchés financiers
800 rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
counsultation-en-cours@lautorite.qc.ca

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario, M5H 3S8
comments@osc.gov.ca

Dear Sirs/Mesdames:

Re: Comment Letter CSA Notice and Request for Comment - Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

Enbridge Inc. together with its affiliates, subsidiaries and related entities (collectively "**we**" or "**Enbridge**") hereby respectfully submits these comments in response to the Authorities' request for

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comments in connection to the Canadian Securities administrators (**"CSA"**) Notice and Request for Comment Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the **"Business Conduct Rule"**); Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the **"Business Conduct CP"**); (collectively the **"Proposed Instruments"**). The Proposed Instruments were published on April 4, 2017 and outline the Authorities' proposals related to the business conduct regime for derivative market participants.

Enbridge appreciates the opportunity to comment on the Proposed Instruments. Although it is a challenge to comment on the Proposed Instruments without the benefit of the CSA's proposed registration regime which was to be published concurrently with the Proposed Instruments. Enbridge would request that when the proposed registration rule and companion policy are available for comment, that the CSA consider allowing for further comments on the Proposed Instruments at that time. In Enbridge's opinion, the business conduct regime and the registration regime are so inter-related that they should move forward and be implemented at the same time.

I. Introduction

On February 27, 2017, Enbridge closed its merger transaction with Spectra Energy. The combination with Spectra Energy created the largest energy infrastructure company in North America with an extensive portfolio of energy assets including the world's longest and most complex crude oil pipeline system and one of North America's leading natural gas delivery companies. In addition to extensive crude oil pipelines and natural gas pipelines (both onshore in Canada and the United States, and offshore in the Gulf of Mexico), Enbridge is the largest natural gas distributor in Canada, owns and operates midstream processing facilities, power generation, power transmission and has an extensive renewable portfolio with both wind and solar assets in Canada, the United States and Europe. Enbridge also has marketing affiliates that provide energy supply and marketing services to North American refiners, producers and other customers.

Like many other "end-users", Enbridge transacts in derivatives to hedge the risks associated with its core business of transporting and processing energy commodities as well as interest rate and foreign exchange risks. Enbridge transacts in derivatives on its own behalf, to mitigate its own risks.

II. Endorsement of Comments

Enbridge is a member of the Canadian Energy Derivatives Working Group; the International Energy Credit Association (**"IECA"**) Contracts & Legal Education Group; and the IECA's Canadian Derivatives Regulatory Working Group (**"IECA Canadian Working Group"**) and fully supports the comments submitted by the IECA Canadian Working Group with respect to the Proposed Instruments.

Enbridge has also reviewed the comments submitted by the Canadian Commercial Energy Working Group ("Working Group") with respect to the Proposed Instruments. Enbridge fully supports the comments submitted by the Working Group.

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III. Enbridge's Specific Comments on the Proposed Instruments

A) Eligible Derivatives Party ("EDP")

The definition of EDP should be consistent with the current, well understood definitions being utilized by the industry, namely "qualified party" under Alberta Blanket Order 91-507 and "eligible contract participant" under the *Commodity Exchange Act* in the United States. Representations utilizing the above definitions are already incorporated into agreements in the industry by many market participants and as such, using already established definitions would reduce additional documentation requirements between entities to comply with any final business conduct regime. Once the representation is made to an entity, it should not need to be renewed, but rather be deemed to be true unless otherwise revoked by the representing entity at a future point in time. Derivative dealers should be able to rely on the representations being provided by an EDP without further inquiry unless the derivative dealers are aware of some information that would lead them to believe that the representation was false.

Enbridge would also support an EDP definition that refers to **total** assets of at least $25 million versus the currently proposed **net** assets of at least $25 million. Further, an entity should be an EDP as long as any affiliate that provides guarantees in support of the entity's business qualifies as an EDP. Enbridge utilizes what are known as "treasury affiliates" in support of its hedging activities to be the market facing entity. While the treasury affiliates would not qualify as EDP's on their own, they are all supported by guarantees from entities that would qualify as an EDP. Having less market facing entities reduces costs substantially and is more efficient, as complex master hedging agreements do not have to be negotiated for each and every entity or project that may require hedging.

B) Business Trigger Guidance

Enbridge agrees with the Working Group and the IECA Canadian Working Group that hedging entities need to be able to regularly quote prices on one or both sides of the market and that they should not be considered a derivatives dealer for engaging in this activity. Further, the business triggers are problematic as they are open to subjective interpretation. Enbridge would strongly endorse the utilization of a de minimis exception as outlined in the Working Group's White Paper attached to their comment letter. The consequences of becoming a derivatives dealer are significant and market participants require certainty that their activities do not move them out of the "end user" category into the derivatives dealer category.

C) Senior Derivatives Managers

The requirement to have a senior derivatives manager supervise activities within their functional business unit is not best practice from a compliance perspective. Best practice would require a group outside the group transacting in derivatives (such as an enterprise risk group) to create, maintain and enforce policies that regulate the derivative activities thorough delegations of authority, quarterly compliance reviews and reporting up to senior management levels. There is an inherent conflict of interest in the Proposed Instrument and the concept should be removed.

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D) Recordkeeping

The recordkeeping requirement of the Proposed Instrument is overly broad. A further complication is that not all transactions, in particular commodity transactions, are conducted in the same manner. Some transacting activities for certain commodities may not be done over the phone at all, with other forms of communication and technology being preferred by the industry such as instant messaging. These "records" are then replaced within a very short time frame with written or electronic confirmation of the terms of the transaction by the parties, and so recording and storing phone records and instant messages has limited value to the parties.

IV. Conclusion

Enbridge thanks the Authorities again for the opportunity to submit our comments on the Proposed Instruments and sincerely hope the Authorities would consider our comments and recommendations as the Authorities draft its final rules to establish a regulatory regime for the OTC derivatives market in the multilateral jurisdictions. We would be pleased to discuss our thoughts with you further. If you have any questions or comments, please contact the undersigned.

Respectfully submitted,

Enbridge Inc.

Kari Olesen, Legal Counsel

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EXECUTION COPY

September 1, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan)
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Grace Knakowski
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comments@osc.gov.on.ca

Re: Comments with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

The International Swaps and Derivatives Association, Inc. (***ISDA***[1]) appreciates the opportunity to provide comments with respect to Proposed National Instrument 93-101 *Derivatives: Business*

[1]Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members comprise a broad range of

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Conduct (the ***Instrument***) and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the ***CP*** and, collectively with the Instrument, the ***Proposed Rule***). The Proposed Rule was published by the Canadian Securities Administrators (***CSA***) on April 4, 2017 and contains the CSA Derivatives Committee's proposal for a harmonized business conduct regime for derivatives across Canada.

ISDA has been actively engaged for a number of years with providing input on regulatory reforms impacting derivatives in major jurisdictions globally, including Canada. ISDA commends the CSA Derivatives Committee for its careful consideration of the issues addressed by the Proposed Rule and welcomes further dialogue with the Committee as it considers the comments and feedback on the Proposed Rule.

PART I - SPECIFIC FEEDBACK ON CSA QUESTIONS

In the CSA Notice and Request for comment, the CSA requested feedback on a number of specific issues. We have set out our responses to the CSA's specific questions below.

1. Definition of "eligible derivatives party"

As currently drafted, the definition of "eligible derivatives party" is generally similar to the definition of "permitted client" in National Instrument 31-103, with a few modifications to reflect the different nature of derivatives markets and participants. Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of eligible derivatives party (***EDP***) should include all of the entities that qualify as "permitted clients" under National Instrument 31-103. The derivatives industry will face an enormous compliance burden if existing disclosures and representations by clients regarding their "permitted client" status cannot be leveraged to determine EDP status under the Proposed Rule. From an investor protection standpoint, we do not believe that potential compliance burden is warranted. If an entity is eligible to participate in the exempt securities market, it does not need the full set of disclosures and protections contemplated under the Proposed Rule for non-EDPs. An investor that is sophisticated enough to purchase a principal-at-risk note without a prospectus is, in our view, sophisticated enough to enter into a derivatives transaction as an EDP. For many market participants, derivatives are risk management products (and not investments) which carry less risk of loss than certain securities purchased in the exempt securities markets. Also, given that they usually have an ongoing credit relationship with their derivatives counterparties, derivatives dealers have an extra incentive to appropriately assess and manage risk with their derivatives counterparties (especially regarding their ability to pay); this is not true in the exempt securities market where dealers are not exposed to the investor's credit risk on an ongoing basis.

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derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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Given the existing definitions of "accredited investor" for prospectus disclosures under National Instrument 45-106 and "permitted client" under National Instrument 31-103, a different definition for EDPs would result in market participants trading prospectus exempt securities and derivatives having to analyze and give representations with respect to three separate definitions. Participants in the global derivatives markets have incurred significant costs in recent years overhauling their onboarding procedures and reference data systems to classify counterparties under the many different rule sets and related definitions implemented as part of the G20 reform agenda (including, most recently, in connection with new rules for margin for uncleared derivatives). Unless dealers and advisers are able to rely on existing representations and disclosures regarding their clients' "permitted client" status, a large scale outreach effort will be required to determine the EDP status of all counterparties in order to implement the Proposed Rule. ISDA submits that no compelling policy reason has been identified which would justify imposing such a significant compliance burden on the derivatives markets in Canada.

ISDA also believes the EDP definition should include a category for hedgers (similar to the hedger category in the definition of "accredited counterparty" under the *Derivatives Act* (Quebec)). Given the additional compliance burden associated with dealing with non-EDPs, it is possible that dealers will not transact with hedgers if they do not qualify as EDPs. In our view, parties entering into OTC derivatives for hedging purposes do not require the additional disclosures and protections contemplated in the Proposed Rule primarily because such parties are using derivatives as a risk mitigation tool. A definition of EDP that does not include hedgers could ultimately harm Canadian hedgers by effectively forcing them out of the derivatives market or by placing them at a disadvantage from a pricing and liquidity perspective.

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

ISDA supports the inclusion of individuals in the definition of EDP; we strongly believe that individuals who meet the financial thresholds in paragraph (o) of the permitted client definition and are able to participate in the exempt securities market should also be treated as EDPs for purposes of the Proposed Rule. As discussed below, we also believe such individuals should qualify as EDPs without the need for additional written representations regarding knowledge and experience.

The Proposed Rule would require individuals that qualify as EDPs to waive in writing the second tier of requirements under the Proposed Rule in order for those second tier requirements not to apply. ISDA submits that such a waiver is not necessary and that individuals that are EDPs should automatically be exempt from the second tier requirements similar to every other category of EDP. In the alternative, if the CSA decide to retain this waiver requirement in the final rule, we request that the requirement to obtain a new waiver from the individual every 365 days be eliminated, and that the onus be placed on the counterparty to revoke the waiver in that circumstance (as opposed to dealers and advisers having to do an annual outreach to all counterparties in order for waivers to be renewed).

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2. Alternative definition of "eligible derivatives party"

Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

ISDA believes that the "institutional client" definition proposed in CSA Consultation Paper 33-404 should not form the basis for the EDP definition. The exclusion of individuals and the use of a higher financial threshold in the "institutional client" definition would create unnecessary inconsistency in the regulation of securities and derivatives markets. Furthermore, as explained above, the exclusion of hedgers as a category of EDPs would be detrimental to this important group of market participants and would create an inconsistency with "accredited counterparty" definition under the *Derivatives Act* (Quebec).

With respect to the definition of EDP proposed in the Proposed Rule, we request that the CSA reconsider the $25 million net asset threshold in paragraph (m)(ii) of that definition. As noted above, dealers generally have counterparty credit exposure when they enter into derivatives; as a result, dealers carefully assess their counterparty's ability to perform its obligations under any derivatives transactions. We respectfully submit that many sophisticated entities with less than $25 million in net assets should be eligible to transact in derivatives as EDPs under the Proposed Rule. As opposed to increasing the financial threshold, ISDA would ask the CSA to consider lowering the threshold in paragraph (m)(ii) of the EDP definition to $10,000,000. This would protect a significant segment of the Canadian derivatives market participants from ultimately bearing the cost of additional regulatory burdens that compliance with provisions applicable to non-EDPs would require. We also wish to point out that this approach would be consistent with the "eligible contract participant" definition under the US *Commodity Exchange Act* which uses a USD $10,000,000 total asset test and would thus ensure Canadian market participants are not placed at a disadvantage in comparison to their counterparts in the United States.

3. Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"

Clauses (m) and (n) of the definition of "eligible derivatives party" provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, "the characteristics of the derivatives to be transacted". The corresponding section of the companion policy notes that "some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type".

While we appreciate the investor protection objective of the CSA, we respectfully submit that the requirement for written representations regarding requisite knowledge and experience in paragraphs (m) and (n) of the EDP definition is unnecessary and has the unintended effect of disadvantaging sophisticated derivatives parties that currently benefit from participation in the derivatives market. As is the case currently in the exempt securities market, we believe financial thresholds are sufficient to identify derivatives parties who are not in need of extra protections, whether individuals or not, and who have sufficient financial resources to purchase professional advice (where necessary) or are otherwise sophisticated parties that can independently assess

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their risks and make their own judgments regarding their derivatives transactions. As noted above, requiring such written representations would deviate from the existing "permitted client" definition in a way that would require firms to canvass their full client population to ascertain EDP status (as opposed to relying on existing "permitted client" representations that firms have already obtained). In our view, this would have the unintended effect of imposing a significant burden on both dealers and other market participants and would not provide derivatives parties with any meaningful benefit given that the financial resources test provides a sufficient and objective measure of sophistication, as evidenced by its current use in securities markets and in the US derivatives market.

In addition to obtaining written representations, the CP would require firms to assess the reasonableness of relying on a derivative party's representations regarding their knowledge and experience. In our view, this creates unnecessary ambiguity around the determination of a derivatives party's EDP status. If the requirement to obtain such representations is retained by the CSA in the final definition of EDP, we submit that derivatives firms should be able to rely on those representations absent having any basis or grounds to believe the representations are false. We believe it is unduly burdensome to impose an affirmative obligation on dealers and advisers to assess the reasonableness of counterparty representations absent a basis or grounds for believing the representations are not true.

If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives? Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

ISDA submits that it would be very difficult, if not impossible, for dealers and advisers to obtain, implement and manage EDP status determinations on a product level. While derivative firms may choose to limit the types of products they transact with certain derivative parties (for suitability or other reasons), we do not think that process should be managed by making EDP status a product-level determination. Given the broad range of products traded in the derivatives market, it would be very difficult to come up with product categories that could work on a market wide basis. From a pure implementation standpoint, such an approach would be extremely challenging to integrate into current processes and existing trading and operations workflows and we are not aware of similar product level differentiation in the context of derivatives business conduct rules in other jurisdictions. We respectfully submit that this approach would introduce enormous complexity without any benefit.

4. Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties

Do you agree with the two-tiered approach to investor/customer protection in the Instrument?

While ISDA generally supports the two-tiered approach, we do not think it goes far enough in addressing the institutional market in derivatives. We suggest the CSA introduce a third tier for

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transactions between dealers (both foreign and domestic) which would be exempt from all requirements in the Proposed Rule (effectively an outright exemption for the inter-dealer market). Such an approach, for example, would allow foreign dealers to transact with Canadian dealers (including Canadian banks) without having to address the Proposed Rule. Absent such a “third tier”, foreign dealers that only participate in the inter-dealer market may be reluctant to continue to transact with Canadian dealers due to the increased compliance burden. This could result in less liquidity being available in the Canadian markets. We submit that even the limited requirements applicable to EDPs under the Proposed Rule are not necessary in the context of inter-dealer activity and that therefore this third tier is appropriate.

Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

ISDA does not believe that any additional requirements should be applicable to EDPs beyond those contemplated under the Proposed Rule.

Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

As explained in other portions of this letter, ISDA believes a number of the requirements in the Proposed Rule are unnecessary given the nature of the OTC derivatives market in Canada. We are concerned that the Proposed Rule will reduce liquidity and the availability of advisory services in relation to OTC derivatives (particularly in the cross-border context).

In particular, ISDA believes that many of the requirements imposed on both dealers and advisers should not be applicable to advisers. Where an adviser transacts in derivatives on behalf of its investor client, the transaction which is executed is between the investor and the dealer. Therefore, requirements in the Proposed Rule such as the obligation to make disclosures regarding the use of borrowed money or leverage and the daily reporting requirements should only apply to derivatives dealers and should not be imposed on derivatives advisers (which are not a party to the transaction). Similarly, many of the specific obligations imposed on advisers in the Proposed Rule such as fair dealing, conflicts of interest and suitability are covered by an adviser’s fiduciary duties to its client and we do not believe the Proposed Rule should impose duplicative requirements in the context of derivatives.

Should the two tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

ISDA believes that derivatives advisers should be able to look through to the EDP status of their underlying clients in order to determine which requirements in the Proposed Rule must be applied. We believe that this approach should be followed even when a client has invested through an adviser’s managed account platform. We would ask the CSA to reconsider the provision in Section 7(3) of the Proposed Rule which would apply the full set of requirements of the Proposed

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Rule to a derivatives adviser in respect of a managed account of an EDP. In our opinion, the underlying EDP does not need the full set of protections even where they have made a determination that it is appropriate to retain an adviser for expertise that they may not have.

The CSA Notice and Request for Comment indicates that the term "eligible derivatives party" refers to those derivatives parties that "do not require the full set of protections afforded to "retail" customers or investors, either because they may reasonably be considered sophisticated or because they have sufficient financial resources to purchase professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm". We submit that this description covers an EDP investor who has hired a derivatives adviser to manage its assets through a managed account structure. The managed account structure will be subject to the terms of an investment management agreement ("IMA") that has been contractually negotiated between two sophisticated parties. In addition to the contractual obligations set out in the IMA, the adviser will be required to meet its fiduciary obligations to the EDP investor. An EDP that has the benefit of both an adviser and an IMA should need fewer protections under the Proposed Rule than an EDP that transacts with a dealer directly without an adviser.

If, notwithstanding the points made above, the CSA are of the view that the EDP requires additional protections that go beyond what would apply to an adviser to an EDP under the Proposed Rule when a managed account structure is not used, then ISDA submits it should be sufficient to only apply the requirements of Section 11 (Derivatives Party Specific Needs and Objectives) and Section 12 (Suitability). If the CSA are not willing to amend or preferably remove section 7(3) in its entirety in the final rule, we submit at a minimum that an EDP should be able to agree in writing with its adviser to be treated as if it was not in a managed account arrangement (i.e., to waive those provisions that would otherwise apply as a result of the application of section 7(3)).

The costs associated with full compliance with section 7(3) will be significant, and this could result in a reduction in managed account services offered to EDPs. For this reason, we would ask the CSA to reconsider the treatment of managed accounts under the Proposed Rule.

5. Business trigger guidance

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

***Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.**

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if "the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party".

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

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ISDA believes that the guidance in the CP, along with paragraph 39(c) of the Proposed Rule, adequately describes the role of a market maker. However, there are several other aspects of the derivatives dealer definition on which we would like to comment.

As a general matter, we think the proposed definitions of derivatives dealer and derivatives adviser do not offer the level of precision and clarity that would enable derivatives parties to receive definitive legal advice on whether their activities bring them into the scope of these definitions. Given the significance of qualifying as a derivatives dealer or derivatives adviser under the Proposed Rule, market participants need to be able to determine whether they are in scope or not.

Relevant Factors

In our view, the definition of a "derivatives dealer" should be modified to include market making as the only factor that would determine whether an entity is acting as a derivatives dealer. However, if the CSA are not willing to limit the scope of derivatives dealing to market making, in the alternative, we request that the factors in section 1 of the CP be narrowed and clarified. For example, factors such as "engaging in activities similar to a derivatives adviser or derivatives dealer" are very hard to apply in practice and will make it impossible for many entities to definitively determine if they are in scope or not. We submit this is problematic notwithstanding the end-user exemptions contemplated in paragraph 39 of the Proposed Rule. Rather than putting too much reliance on the end-user exemptions, we believe the definitions of derivatives dealer and derivatives adviser should be drafted with greater precision to only capture the entities that are truly engaged in dealing and advising activities.

To that end, we request that the CSA clarify that, absent other factors, the mere act of engaging in frequent or regular trading would not result in an entity qualifying as a derivatives dealer. Similarly, we believe that facilitating or intermediating transactions as a broker - absent other business trigger factors – should not result in an entity being a derivatives dealer. We suggest that references in the Proposed Rule to "business of trading in derivatives" be changed to "business of dealing in derivatives" to better distinguish between dealing and trading activity. We strongly believe that a *de minimis* threshold should be included to avoid entities, whether foreign or Canadian, with limited trading activity with Canadian clients being brought in scope for derivatives dealer status. This approach would be consistent with the notion of the *de minimis* threshold under CFTC rules pursuant to which persons with_USD $8 billion in aggregate gross notional amount of swaps (measured over a 12-month period) are automatically excluded from the definition of a "swap dealer".

Jurisdictional Scope

ISDA believes that the requirements in the Proposed Rule should only apply to dealing or advising activity conducted with Canadian counterparties located in Canada. Certain provisions in the CP suggest that the Proposed Rule might extend to activities conducted in a foreign jurisdiction. We request that the CSA clarify the jurisdictional scope in the final rule.

Agency

The definition of "derivatives dealer" includes companies or persons trading in derivatives as agent. We request that the CSA clarify what agency roles are intended to be captured by this

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part of the definition given that transactions in the OTC derivatives market are generally entered into on a principal basis. The same question arises in paragraph (a)(i) of the definition of "derivatives party" which refers to a derivatives dealer acting or proposing to act as agent in relation to a derivative.

Clearing Services

One of the factors for determining derivatives dealer status is "providing derivatives clearing services". Other than acting as a dealer facing a counterparty in a cleared derivative, we request that the CSA clarify what other clearing services are contemplated. For example, we would ask the CSA to confirm that a firm which acts as a clearing broker would not be considered to be a derivatives dealer solely as a result of acting as a clearing broker.

Exemptions

While ISDA believes that the end-user exemption in section 39 of the Proposed Rule is helpful (particularly given the wide definition of derivatives dealer), we suggest that the CSA supplement the current version of section 39 with specific exemptions for categories of end-users. For example, it would be helpful to have a specific exemption from the derivatives dealer definition for insurance companies, pension funds and investment funds to avoid any ambiguity as to whether they could be in scope as dealers for purposes of the Proposed Rule.

ISDA is of the view that the availability of the end user exemption in section 39 should not be restricted to parties that interact solely with EDPs. A derivatives party's status as an end-user should depend on the activities undertaken by such party in the ordinary course of business as opposed to the type of counterparty with whom that end-user engages. As such, we request that the CSA amend sections 39(a) and 39(b) accordingly. ISDA also believes that the end user exemption should be further amended by removing the words "regularly facilitate" in section 39(d) and deleting section 39(e). We submit that phrases such as "regularly facilitate" and "facilitate" are too ambiguous and would prevent firms, which would otherwise qualify for the exemption in Section 39, from obtaining definitive legal advice as to their end-user status.

6. Fair Dealing

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

While ISDA generally supports the fair dealing model contemplated in section 8 of the Proposed Rule, we submit that the requirement should be to "communicate fairly, honestly and in good faith". An emphasis on communication would better reflect the nature of derivatives relationships (which involve ongoing, bilateral obligations during the course of a transaction) and also align the Proposed Rule with the fair dealing obligations imposed on registered swap dealers under the CFTC rules.

We also believe that the specific requirement in Section 8(3) around allocation of transaction opportunities by derivative advisers is not necessary given the much broader fiduciary standard which derivatives advisers are subject to. ISDA believes that the CSA should take greater account of the fiduciary standard imposed on derivative advisers and avoid imposing duplicative requirements that are already covered by the broader fiduciary framework governing the activities of advisers.

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7. Fair terms and pricing

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

Section 19(1) of the Proposed Rule provides that a derivatives firm that acts as agent for a derivatives party must establish policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available. In the case of advisers, we submit that these requirements are part of the overall duty imposed on a fiduciary and that is it not appropriate to impose specific requirements regarding pricing terms in the context of derivatives.

We also submit that this standard is not appropriate for dealers given that a significant percentage of derivatives transactions are entered into over the counter on a bilateral basis. As noted above, we ask the CSA to reconsider the inclusion of an agency role for derivatives dealers given that OTC derivatives are executed on a principal basis.

Section 19(2) of the Proposed Rule requires derivatives dealers to make a reasonable effort to provide a price for the derivative party this is "fair and reasonable taking into consideration all relevant factors". The CP says that a derivatives firm must take into account both the market value of the derivatives and the reasonableness of compensation in making this determination. ISDA is of the view that this standard is too open ended for derivatives dealers to implement. Prices are a matter of negotiation between the parties and are determined by many factors, including the risk, liquidity and collateral terms associated with the transaction. Users of derivatives are able to compare prices and terms by soliciting quotations from multiple dealers. Imposing a regulatory obligation that prices must be fair and reasonable creates ambiguity and heightened legal uncertainty for dealers and advisers without any clear justification or benefit for derivatives end users. The increased risks associated with this legal uncertainty could discourage dealers and advisers from providing liquidity and advisory expertise to certain segments of the market.

8. Derivatives Party Assets

National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party. Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

ISDA does not believe that derivative party assets (including assets posted as margin) should be regulated as part of business conduct requirements. Unlike in the securities context, derivatives dealers do not carry client assets (other than assets posted or transferred to the dealer to satisfy margin requirements). As a result, ISDA does not see a need for the Proposed Rule to address how derivative party assets are held, used or invested. Such requirements are best addressed (as applicable) in other rules such as the uncleared margin rules modelled on the BCBS-IOSCO margin framework for uncleared derivatives. We would ask the CSA to amend the Proposed Rule to remove the restrictions on the use and investment of posted collateral so as to allow derivatives parties to continue using and investing collateral in accordance with the terms of their collateral

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documentation (subject to any other regulatory requirements such as the margin requirements for uncleared derivatives). We note that the current provisions would have detrimental pricing and liquidity implications for market participants as non-cleared derivatives are currently priced on the assumption that posted collateral can be used or invested in accordance with standard market practice, as reflected in the terms agreed to in the collateral documentation. In addition, ISDA would ask the CSA to clarify that the exemption from Division 2 contained in section 24 of the Proposed Rule is available where parties are relying on the substituted compliance provisions in National Instrument 94-102.

9. Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

ISDA does not think derivatives firms should be required to provide this information. As explained elsewhere in this letter, we do not think derivatives firms should be required to provide valuations (or any related inputs and assumptions). Instead, the obligation should be limited to providing a mid level mark consistent with the approach followed by swap dealers under CFTC rules.

If it is necessary for an adviser to provide valuation information to its clients, we would submit that daily valuation reporting is both onerous and unnecessary. It should be sufficient for an adviser to provide such reporting on a monthly basis unless otherwise agreed in writing. That approach would be consistent with the current practice in the securities markets.

10. Senior derivatives managers

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

While we agree that senior derivatives managers should be responsible for supervising, promoting compliance and addressing non-compliance within their business units, we believe the imposition of a specific responsibility to prevent non-compliance as provided in the Proposed Rule is not appropriate. Where such a duty has been introduced for senior managers in other jurisdictions (such as the UK senior manager's regime), it has been part of a comprehensive framework across business lines that includes responsibility mapping, employee certification and allocation of prescribed responsibilities at the enterprise level. The Proposed Rule would charge a senior derivatives manager with taking reasonable steps to prevent non-compliance "with respect to the derivatives activities conducted in his or her derivatives business unit". We submit that such broad-based responsibility is never assigned to a single individual but is a shared responsibility across multiple functions, including compliance, risk and the board. For that reason, we submit that this specific requirement in Section 33(1)(c) of the Proposed Rule should be reconsidered.

The Proposed Rule says a senior derivatives manager would be "in breach in terms of identifying and reporting non-compliance even if the senior manager has delegated responsibilities and has not been properly advised of the non-compliance". With respect to delegation, we submit that the responsibility of the senior derivatives manager should be to ensure that any delegation is to an

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appropriate person and that they oversee the delegation effectively. There should be no automatic breach for failure due to the action or inaction of someone to whom responsibilities have been properly delegated.

The reporting obligation in section 33(2) contemplates reporting to the board of directors (or individuals acting in a similar capacity for the derivatives firm). ISDA submits that reporting at this level of a derivatives firm (i.e., the board or equivalent body) may not be appropriate in all cases. There should be flexibility to submit the reports contemplated in section 33(2) to senior management in lieu of reporting to the board (or its equivalent). For example, in the case of a large firm with a relatively small derivatives business unit, it would be appropriate for the reports under section 33(2) to be made to senior management (with reporting to the board (or the applicable equivalent body) where the contents of the report merit escalation). We also submit that the reporting obligation should be the responsibility of the chief compliance officer ("CCO") of the derivatives firm or, alternatively, the CCO or the senior derivatives manager (as determined by the derivatives firm).

The CP states that the senior derivatives manager must exercise reasonable care in determining when and how often material non-compliance should be reported to the board of directors. For example, in the case of "serious misconduct", the CP says the board should be made aware of the matter "promptly" and that it should be reported to securities regulators in a "timely manner". ISDA suggests that the language in the second bullet of section 34 of the CP be amended to add the words "after review by the board" following the words "timely manner" in order to make it explicit that derivatives firms will have an opportunity to raise the issue with their board before being required to report to the regulators.

ISDA asks the CSA to confirm that the list of examples of material non-compliance set out in the CP is meant to reflect what the CSA mean by "serious misconduct". It is our view that the example that currently reads: "has, or could have, a negative impact on the interest of a derivative party," is too far reaching. We request that this example be removed or revised to incorporate a materiality component.

We agree that it is appropriate to report matters that constitute "serious misconduct" to the board and regulators more frequently than annually. However, we would submit that it should be sufficient to report to the regulators all other instances of material non-compliance "no less frequently than on an annual basis" and following the review of the annual report by the board as contemplated in Section 33(2).

Annual certification that the business unit is in material compliance with the Proposed Rule, applicable securities legislation and policies and procedures of the derivatives seems disproportionate and unnecessary given the proposed responsibility to report instances of non-compliance. We submit that the annual certification requirements should be excluded in the final rule.

We would also ask the CSA to consider the possible implications of imposing the senior derivatives manager regime in the context of cross-border activities. If derivatives firms that are not subject to such a regime in their home jurisdiction are required under the Proposed Rule to implement this framework just for Canadian local clients, this requirement could act as a disincentive to continuing to provide services to Canadian clients. While ISDA supports a robust customer protection regime for Canadian derivatives clients, we caution against imposing requirements that are so out of step with other major jurisdictions that they could result in less cross-border liquidity and advisory expertise being made available for Canadian clients.

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11. Exemptions

Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

While ISDA supports the provisions in the Proposed Rule which would allow substitute compliance, the potential benefits will only be known once the CSA indicate which corresponding domestic and foreign laws can be complied with in lieu of the Proposed Rule and the residual provisions of the Proposed Rule which will still need to be followed in each case. We request that the CSA publish those corresponding laws and applicable residual provisions for consultation in advance of finalizing the Proposed Rule so that market participants can provide feedback. While ISDA was not directly involved in the work done by the Canadian Market Infrastructure Committee ("CMIC") in identifying comparable domestic and foreign laws that should qualify for substitute compliance under the Proposed Rule, we would refer the CSA to the results of CMIC's analysis which is included in CMIC's comment letter to the CSA on the Proposed Rule.

In order to rely on the exemptions in Section 40 and Section 44, foreign dealers and foreign advisers must provide a disclosure statement to the derivative party (pursuant to Section 40(3)(c) in the case of foreign dealers and Section 44(3)(c) in the case of foreign advisers. A similar statement must be delivered by all non-resident derivatives firms pursuant to Section 23 but only to derivative parties that are not EDPs. Given that foreign dealers and foreign advisers can only rely on the exemptions in Section 40 and Section 44 if they limit their activities to EDPs, it seems inconsistent to require them to deliver a statement if Section 23 only requires the statement to be delivered to non-EDPs. We submit that EDPs do not require this information and that the conditions in Section 40(3)(c) and Section 44(3)(c) of the Proposed Rule should be deleted.

The exemption for foreign dealers and adviser based on substituted compliance is not available if the dealer or adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. We submit that this restriction should not be necessary and ask the CSA to clarify why trading on such an exchange or DTF should make the dealer/adviser ineligible for substitute compliance provided they only deal with EDPs.

PART II - ADDITIONAL COMMENTS

In addition to the responses to the specific questions raised by the CSA, ISDA has other comments on the Proposed Rule which are set out below.

1. Effective date and scope of proposed rule

We submit that the requirements in the Proposed Rule should only come into effect after the proposed registration regime for derivatives firms is in place to allow sufficient time to implement appropriate policies and procedures, train relevant personnel, receive any required representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation. Also, to the extent the CFTC proposes

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amendments to its business conduct standards as part of its recently launched KISS review, we would ask the CSA to delay finalizing its business conduct proposals until any amendments to the CFTC business conduct proposals are finalized. It is important in our view that Canada remain harmonized as much as possible with large markets for derivatives like the United States.

We request that the CSA clarify that the requirements in the Proposed Rule will not apply to unexpired derivatives that were entered into before the effective date of the Proposed Rule other than ongoing requirements (i.e., fair dealing (Section 8), daily reporting (Section 22) and derivatives party statements (Section 30)).

Section 46(1) of the Proposed Rule contemplates grandfathering of derivatives that are entered into before the effective date of the Proposed Rule and which expire or terminate not later than 365 days after that date. We submit that, other than the ongoing obligations identified above, all pre-effective date transactions (regardless of their remaining term) should be grandfathered. That grandfathering should apply even if pre-effective date transactions are subsequently amended after the date of any final rule.

ISDA supports the exclusion of governments, central banks and international organizations (collectively, "Section 6 Excluded Entities") from the requirements of the Proposed Rule. We are unclear if Section 6 is saying that Section 6 Excluded Entities are not derivatives dealers and derivatives advisers or if the intention is that the requirements of the Proposed Rule should not apply whenever at least one party is a Section 6 Excluded Entity. ISDA believes the Proposed Rule should not apply if either party to a transaction is a Section 6 Excluded Entity and we would ask the CSA to clarify Section 6 accordingly in the final rule. ISDA also submits that the list of Section 6 Excluded Entities should include "crown corporations, government agencies and any other entity which is wholly owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities". We also submit that the reference to "government of a foreign jurisdiction" in Section 6(a) should be expanded to explicitly include state, regional and local governments in foreign jurisdictions.

2. Conflict of interest

ISDA suggests that the CSA consider amending the requirements in section 9 of the Proposed Rule related to disclosure of conflicts of interest as follows:

(a) Given that advisers are subject to broad fiduciary obligations, we do not believe it is necessary or appropriate to impose specific conflict of interest requirements in the context of their derivatives advisory activities. The elements of the conflict of interest rule applicable to derivatives advisers – including the requirements under the heading "Competing interests of derivatives parties" – are covered as part of the fiduciary standard. For this reason, ISDA suggests that the obligations in section 9 of the Proposed Rule should only apply to derivatives dealers.

(b) Consistent with industry practice, standardized disclosures should be permitted provided additional or particularized disclosures are made available in connection with specific transactions as appropriate. It should be sufficient if standardized disclosures are provided reasonably sufficiently prior to a transaction is entered into (including through website disclosure).

(c) The CP lists "acting as both dealer and counterparty" as an example of a conflict of interest that must be disclosed. We submit that market participants generally

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understand that the interests of two parties to a derivative are divergent (i.e., they are on opposite sides of a transaction). It is not customary to disclose this fact as part of conflicts of interest disclosure and we recommend that it be deleted from the Proposed Rule.

(d) The CP lists “competing interests of derivatives parties” as an example of a potential conflict of interest, and says that the CSA expect a derivative firm to make reasonable efforts to be “fair to all such derivative parties”. This requirement is quite vague and it is unclear what obligations the CSA is seeking to impose in this context. We request that the CSA further explain what this requirement is seeking to address or otherwise consider deleting it from the Proposed Rule.

(e) The CP lists “compensation practices” as an example of a potential conflict of interest, and suggests that there may be circumstances where compensation may be a reason not to offer a product to a derivative party. We submit that a derivative firm’s obligation in this context should be to make the required disclosures. While a derivative firm may decide not to offer a derivative to a particular counterparty, we submit that the amount of compensation associated with a transaction is generally not – in and of itself – a conflict of interest.

(f) The Proposed Rule lists avoidance as one of the reasonable methods of response to a conflict of interest. However, beyond cases where the conflict of interest is prohibited by law, it is unclear when a market participant would be expected to avoid a conflict. The CSA states in the CP that “where conflicts of interest are so contrary to another person’s interest that a derivatives party cannot use controls or disclosure to reasonably respond to them, we expect that the derivatives firm to avoid the conflict, stop providing the service or stop dealing with the derivatives party”. This standard is vague. In the context of an arm’s length trading relationship, it would be difficult if not impossible in many cases for a derivatives dealer to know or determine what the other party’s interests may be. Confronted with such a vague standard, derivatives firms will struggle to determine if withdrawal of services is required or if its regulatory obligations can be met through control and disclosure. For conflicts of interests that are not prohibited by law, we submit that the only regulatory requirement should be to identify and disclose material conflicts.

(g) Under the subheading “Controlling conflicts of interest”, the CP refers to “advisory staff reporting to marketing staff” as an example of a situation that would likely raise a potential conflict of interest. ISDA assumes this reference is meant to capture the divide between public side and private side employees and the need to ensure that reporting lines respect public/private side information barriers. If this is the case, we request that the CSA clarify this point in the Proposed Rule.

(h) We submit that an exemption from the conflicts of interest requirement is necessary where the derivatives dealer does not know the identity of its counterparty prior to execution and therefore cannot identify and address conflicts of interest as contemplated in the Proposed Rule. This would be the case, for example, where transactions are initiated on a swap execution facility (“**SEF**”).

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3. General know your derivative party requirements

Section 10(2)(c) of the Proposed Rule would require derivatives dealers and derivatives advisers, in connection with securities based derivatives, to establish if their counterparty (i) is an insider of a reporting issuer or any other issuer whose securities are publicly traded or (ii) would be reasonably expected to have access to material non-public information (MNPI) relating to any interest underlying the derivative. We suggest that the CSA reconsider these requirements. ISDA is not aware of an analogous requirement under similar KYC rules for derivatives in other jurisdictions. While it may make sense to require this information in the context of securities trading, we do not see why this information should be required for derivatives. Given that derivatives (including index based products) can reference many different underling issuers, it would not be practicable for derivatives firms to collect this information and keep it current. It is also unclear if this information regarding possession of MNPI would need to be assessed each time a derivative referencing an underlying issuer is entered into. To the extent the CSA are concerned about parties transacting in security-based derivatives while in possession of MNPI, we suggest that this should be addressed in another manner (and not by making derivatives firms collect the information as part of KYC requirements).

Section 10(4) of the Proposed Rule requires derivative firms to take reasonable steps to ensure that KYC information required under Section 10 is kept current. ISDA submits that the onus should be reversed and that the information collected under section 10 should be deemed to be current unless a client informs a derivatives firm otherwise.

ISDA also requests that the exception in Section 10(5) be expanded to cover all EDPs or, if that is not deemed appropriate, at least to cover all EDPs that are regulated entities.

4. Suitability

Section 12 of the Proposed Rule provides that both derivative dealers and derivative advisers must take reasonable steps to ensure that, before they make a recommendation to or accept an instruction from a derivative party to transact in a derivative, the transaction is suitable for the derivative party. In the context of derivatives advisers, we believe that such obligations are already covered by the adviser's broader fiduciary obligations and we do not think a specific suitability obligation specifically for derivatives is necessary or appropriate.

In the case of derivative dealers, the suitability obligation in Section 12 should only be triggered when the derivative dealer has made a recommendation; suitability obligations should not apply simply as a result of an "instruction … to transact". The Proposed Rule does not contain a definition of "recommendation"; we request that the CSA issue further guidance regarding the factors to be considered when determining whether a communication constitutes a "recommendation". We submit that a communication should only constitute a recommendation where is tailored to a particular client (or category of clients) and can reasonably be viewed as a "call to action".

Given that dealers transact with their counterparties as principals (and not as advisers), it is important that the CSA include a safe harbour from the suitability requirements in the Proposed Rule for circumstances where the derivatives dealer obtains appropriate representations from the counterparty (or, where applicable, its agent) and discloses to the counterparty that it is not assessing suitability. A waiver option similar to that provided in Section 13.2(6) of National Instrument 31-103 should also be included in the Proposed Rule. It is also important that the Proposed Rule be amended to include a carve-out from suitability for transactions executed on a

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venue (like a SEF) where the derivatives dealer is not able to assess suitability due to the anonymous nature of the trade execution. A carve-out from suitability obligations should also be available for dealers where they execute block trades with an adviser acting on behalf of multiple underlying accounts; the dealer may not know at the time of execution which of the adviser's accounts will be allocated the trade and therefore it will not be possible to assess suitability in advance of trading.

Relief from suitability requirements should also be available for derivatives that are intended to be cleared ("ITBC Transactions") for the same reasons outlined by the CFTC in CFTC No Action Letter 13-70 (a copy of which can be found at http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-70.pdf). We think the same reasons why the CFTC granted relief in this context are applicable in the Canadian market.

Similar safe harbors and carve-outs to those discussed above should be added to the Proposed Rule for the KYC requirements in Section 11.

5. Referral arrangements

Sections 13 to 15 of the Proposed Rule would impose documentation, recordkeeping and disclosure obligations whenever a derivative firm enters into an arrangement to pay or receive any form of compensation, direct or indirect, for the referral of a derivative party to or from the derivative firm.

ISDA believes that these referral arrangements are too broad. While CFTC rules prohibit swap dealers from making certain referrals to counterparties that qualify as "special entities", they do not impose requirements on referral arrangement similar to those contemplated under the Proposed Rule. At a minimum, we would argue that requirements should only apply to referral arrangements that specifically involve derivatives.

6. Disclosure regarding the use of borrowed money or leverage

Section 16 of the Proposed Rule would require derivatives firms to provide a written disclosure statement regarding the use of borrowed money or leverage to a derivatives party prior to entering into a transaction. To avoid duplicative disclosure to clients, ISDA believes this obligation should only apply to derivatives dealers. We also request that the CSA confirm that posting of the disclosure on a derivative firm's website in a readily accessible location will be sufficient for purposes of ensuring the relevant disclosure has been provided (and refreshed as required).

7. Derivatives Party Accounts - Disclosure to Derivative Parties

We submit the some of the relationship documentation listed in Section 20(2), which may be relevant in the context of a securities account, is not applicable for a derivatives relationship. For example, the requirement to describe the risk of using borrowed money to finance a derivative seems unnecessary given that market participants do not generally use borrowed money to finance derivatives in the same way parties regularly purchase securities on margin. Similarly, we do not see how the disclosure requirement with respect to performance benchmarks (section 20(2)(m)) is applicable in the context of derivatives.

In addition, we note that Section 14.2(3) of NI 31-103 permits oral disclosure of the information referred to in Section 20(2)(b) of the Proposed Rule in addition to written disclosure in the context of the securities markets. We request that Section 20(2) be revised to incorporate this same

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approach for the derivatives markets as we are of the view that a different approach is not necessary or justified when the information is simply a general description of the products and services that the derivatives firm offers.

8. Derivatives Party Accounts - Pre-transaction Disclosure

We submit that the requirement in Section 21(1)(a) for derivatives dealers to provide a derivative party with “an analysis of the derivative party’s potential exposure under the type of derivative” should only apply where the analysis is requested by the counterparty. This would align the Proposed Rule with requirements under the CFTC rule to provide scenario analysis upon request.

We request that the CSA confirm that standardized disclosures of materials risks and material characteristics are acceptable where appropriate. We also request confirmation that such disclosures can be made by directing a derivatives party to the appropriate page on a derivative firm’s website where the disclosures are available.

We would ask the CSA to confirm that pre-transaction disclosures of all kinds do not apply where a derivative transaction is an ITBC Derivative and/or is initiated on a venue (e.g., a SEF). Whether a SEF transaction is executed anonymously or not, it is the SEF that onboards the counterparty (not the dealer) and therefore there should be no onus placed on the dealer to promote properly functioning SEF trading.

Section 21(2)(b) provides that a derivatives dealer must disclose “if applicable, the price of the derivative to be transacted and the most recent valuation”. We have the following comments on this sub-clause:

(a) We would ask the CSA to clarify the inclusion of the phrase “if applicable” (i.e., when would it not be applicable to disclosure these items).

(b) To avoid any suggestion that derivatives firms are providing valuation services, we would ask the CSA to amend the reference to “recent valuation” to “mid-market mark”. Consistent with the CFTC rules, we submit the mid-market mark should not include amounts for profit, credit reserve, hedging, funding, liquidity or other costs or adjustments.

(c) If price and mid-market mark are disclosed, we request that the CSA reconsider requiring derivatives firms to provide additional disclosure “with respect to spreads, premiums, costs, etc.” as contemplated in the CP.

Section 21(2)(c) requires disclosure of “any compensation or other incentive payable by the derivative party related to the derivative or the transaction in the derivative”. We would ask the CSA to clarify what additional information this is intended to capture (other than the disclosure under 21(2)(b)).

9. Daily Reporting

We submit that the requirement in Section 22 of the Proposed Rule to make available a daily “valuation” with respect to a derivative should instead be a requirement to make available a “mid-market mark”. We also request that the CSA clarify that this requirement only applies to uncleared derivatives; in the case of cleared derivatives, it should be sufficient for the derivatives firm to notify the derivatives party of its right to request and receive the clearing agency’s daily mark. We

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also request that this obligation only apply to derivatives dealers and not to derivatives advisers given that advisers are not parties to the transactions being executed. As indicated above, daily valuation reporting is both onerous and unnecessary. It should be sufficient for an adviser to provide such reporting on a monthly basis, unless otherwise contractually agreed, which is consistent with the current practice in the securities markets.

10. Derivatives Party Statements

Sections 30(2)(d) and 30(2)(f) of the Proposed Rule refer to derivatives party assets “held by” the derivatives firm. We would ask the CSA to clarify when derivatives party assets, whether collateral or otherwise, are considered to be “held by” a derivatives firm, with specific examples that may apply to a derivatives dealer and a derivatives adviser.

11. Reporting to derivatives parties: Transaction Confirmations

While we agree and support the requirement that transactions be confirmed in writing as contemplated in paragraph 29(1) of the Proposed Rule, we submit that the prescriptive requirements as to the contents of those confirmations are not appropriate and are inconsistent with the rules in other jurisdictions related to trade confirmations for derivatives. We request that the CSA clarify that this requirement only applies to uncleared derivatives. We also would ask the CSA to confirm that electronic confirmations (including SWIFT confirmations) satisfy the “in writing” requirement.

12. Recordkeeping

For transactions that are initiated on a SEF, ISDA requests that the CSA provide an exemption from the requirement in section 35 to enter into a derivatives agreement with a derivatives party before transacting.

We also note that the requirement in section 35(1) to have an agreement in place with a counterparty before entering into a transaction is not practicable in the context of foreign exchange trading where firms regularly enter into transactions prior to completing an ISDA Master Agreement. We request that the CSA include a carve-out from this requirement for foreign exchange transactions as well as all cleared derivatives.

With respect to recordkeeping, ISDA believes the CSA should implement a single (and shorter) record retention period of five years from the date of termination of the derivative.

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ISDA and its member would like to reiterate our appreciation to the CSA for the opportunity to provide feedback on the Proposed Rule. We are happy to discuss our responses and to provide any additional information that may be helpful.

Thank you for your consideration of these important issues to market participants. Please contact the undersigned if you have any questions or concerns.

Sincerely,

Katherine Darras
General Counsel
International Swaps and Derivatives Association, Inc.

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Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Dear Sirs/Mesdames:

Notice and Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP

Osler Hoskin & Harcourt LLP ("**Osler**") appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") in response to the notice and request for comments regarding the above-noted Proposed National Instrument 93-101 – *Derivatives: Business Conduct* ("**NI 93-101**") and Companion Policy ("**CP**") (together, the "**Proposed Instrument**").

As counsel to a wide array of financial and commercial entities, Osler has extensive involvement with derivatives transactions and derivatives regulation. Our perspective shared in this comment letter has been informed by input from clients that will be subject to the Proposed Instrument, and end-users who will be impacted by the changes in business conduct that the Proposed Instrument mandates. While we regard the Proposed

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Instrument as a laudable step towards harmonizing business practices in the derivatives markets, we wish to outline in this letter the areas that we believe require further scrutiny and revision. Additionally, attached as Schedule 1, we have responded to the specific questions posed by the CSA.

1. **Business trigger for derivatives adviser and derivatives dealer**

We have two structural concerns with the business trigger guidance for derivatives dealers and derivatives advisers in the CP. First, we believe that the business trigger guidance should appear in the companion policy to planned National Instrument 93-102 – *Derivatives: Registration* ("**NI 93-102**"). The articulation of factors to determine whether a party is a derivatives dealer or derivatives adviser should be located in a registration rule, not a business conduct rule. The current placement of the business trigger factors in the CP begs the question of whether those factors will be duplicated in a future companion policy to NI 93-102, or whether the CSA could proceed with the introduction of the Proposed Instrument without a registration regime (an alternative which we would strongly oppose). While we acknowledge and accept that an entity exempt from the dealer or adviser registration requirements may still be subject to certain business conduct requirements, it does not logically follow that the determination of whether a party is a derivatives dealer or derivatives adviser should fall within a business conduct rule.

The second structural concern is that the business triggers for derivatives dealers and advisers have been combined into one list, which is similar to the approach taken in National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"). We view this a step backwards from the approach proposed in CSA Consultation Paper: 91-407 - *Derivatives: Registration*, where there were separate business triggers articulated for dealers and advisers. Our clients that may be engaged in the business of advising in derivatives find it particularly difficult to parse through the proposed business trigger factors in the CP to determine what is relevant to their advisory business activities, given that most of the factors (e.g. "quoting prices or acting as a market maker", "intermediating transactions" and "providing derivatives clearing services" in particular) are dealer-centric. A related concern is that incidental advisory activities, such as advice provided by law, accounting or financial consulting firms on documenting or structuring a derivatives transaction are not clearly excluded from derivatives adviser business trigger factors. We believe that separate business trigger factors for derivatives dealers and derivatives advisers, with appropriate interpretive guidance for each set of factors, would be very beneficial for derivatives market participants. For example, for the derivatives dealer business trigger factors it could be clarified that derivatives end users are not dealers and for the derivatives adviser factors it could be clarified that pension fund administrators, lawyers, accountants and others that provide incidental advice related to derivatives are not in the business of advising in derivatives.

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In addition, we urge the CSA to consider clear guidance in the CP that registered and exempt securities dealers and advisers are not subject to the Proposed Instrument simply by virtue of an occasional or incidental derivatives trade as principal or as agent for a client. Consider the example of a registered portfolio manager that trades a basket of equity securities for a client's managed account, and occasionally enters into a total return swap in order to maintain a balanced portfolio. In this example, the additional costs associated with complying with the Proposed Instrument are disproportionate to the very limited derivatives activity of the registered portfolio manager, especially given the fact that the registered portfolio manager is subject to the registrant conduct requirements in NI 31-103.

2. Definition and treatment of an "eligible derivatives party"

In our view, the Proposed Instrument should use the definition of "permitted client" in NI 31-103 to determine which business conduct requirements should apply to dealing with a client or counterparty. While there are many differences between the derivatives market and securities market, the thresholds for determining whether a client or counterparty should receive heightened protections are broadly the same. Requiring derivatives dealers and advisers to comply with another definition to categorize clients and counterparties would be extremely onerous. Any dealer or adviser that already collects and maintains information concerning a client's status as an "accredited investor" and as a "permitted client" should not be required to do the same for "eligible derivatives party" ("**EDP**") absent a compelling policy rationale.

If, however, the CSA concludes that a distinct definition of EDP is necessary, we believe that the definition should be modified in several ways. To that end, we have the following suggestions:

a) In addition to including entities registered or authorized under securities legislation, paragraphs (d) and (k) should be amended to include firms that are registered under commodity futures legislation, including futures commission merchants and commodity trading managers.

b) The EPD definition should be amended to ensure that direct subsidiaries and other entities wholly-owned by EDPs (directly or indirectly) likewise qualify as EDPs. We suggest the following paragraph be added:

> "a person in respect of which all of the owners of interests, direct, indirect or beneficial, except the voting securities required by law to be owned by directors, are persons that are eligible derivatives parties."

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c) EDPs who are individuals with net assets reaching an aggregate realizable value of $25 million should be treated in the same manner as EDPs that are not individuals. We submit that such persons are sufficiently sophisticated to warrant eliminating distinctions in treatment. We would therefore suggest amending sections 7(1) and 7(2) to read as follows:

> (1) " The requirements of this Instrument, other than the following requirements, do not apply to a derivatives firm in respect of a derivatives party that is an eligible derivatives party ~~and that is not an individual~~..."
>
> ~~(2) "The requirements of this Instrument, other than the requirements specified in subsection (1), do not apply to a derivatives firm in respect of a derivatives party who is an eligible derivatives party and who is an individual..."~~

d) Finally, we do not support the inclusion of section 7(3), which subjects a derivatives firm acting as an adviser in respect of a managed account of an EDP, to the entirety of the Proposed Instrument. Respectfully, this provision should be struck from NI 93-101. A derivatives adviser acting for a sophisticated party, that would otherwise be exempt from many of the proposed rules, should not be made to comply with the same requirements applicable to dealers and advisers trading for "retail" clients or accounts. If, however, the provision is to remain in NI 93-101, we would urge the CSA to include a carve-out that allows EDPs that have retained the services of a derivatives adviser for a managed account to waive the application of "retail" requirements.

3. Part 3: Dealing with or advising derivatives parties

a) *Fair Dealing and Conflicts of Interest*

We are generally supportive of the requirements set out in section 8 [fair dealing] and section 9 [conflicts of interest]. However, we believe that the sections should each be amended to include exemptions for derivative firms dealing with derivatives parties that are: (i) other derivative firms (whether registered, or exempt from registration), (ii) Canadian financial institutions or (iii) foreign financial institutions.

Also, it is not clear to us that there are any material differences between the fair dealing requirements set out in section 8 and the fair terms and pricing requirements set out in section 19. Perhaps section 19 can be interpreted to be specific manifestations of the more general requirements in section 8. If so, we believe that the discussion of fair terms

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and pricing in section 19 is better suited to appear as part of the CP guidance on fair dealing.

b) ***Know your Derivatives Party***

Section 10(2)(a) of NI 93-101 [know your derivatives party] requires derivative firms to "establish, maintain and apply reasonable policies and procedures to…obtain such facts as are necessary *to comply with applicable federal and provincial legislation* relating to the verification of a derivatives party's identity." Respectfully, this obligation is overly broad and should be removed from 93-101. It is not appropriate to include an undefined and general obligation to comply with "other" applicable legislation in the instrument. Should the CSA feel strongly that derivatives firms be reminded of their obligation to comply with other applicable legislation, this should appear in the CP or in a staff notice.

Also, although we support the exemption set out in section 10(5) (releasing derivatives firms from compliance with identity verification requirements in respect of derivatives parties that are registered firms or a Canadian financial institutions), we believe that the exclusion is unduly narrow. The provision should be revised to include derivatives firms that are exempt from registration requirements, as well as foreign financial institutions.

c) ***Derivatives-Party Specific Needs and Objectives, and Suitability***

The information-collection requirements outlined in section 11 [derivatives-party specific needs and objectives] function as a pre-requisite to compliance with section 12 [suitability]. As such, we believe that they are better suited to appear as part of the CP guidance on suitability. Alternatively, if the section is to remain in the text of NI 93-101, sections 11 and 12 should be combined to form one clear and comprehensive set of obligations. We would also request that the language of section 12 be clarified to convey that a determination of suitability need not be made on a trade-by-trade basis if a discrete trade fits into a larger trading strategy or series of trades, for which suitability can be assessed.

4. Reporting Material Non-Compliance

We are concerned that section 34(b) [reporting material non-compliance] places a broad and onerous self-reporting burden on derivatives firms without precedent in Canadian securities legislation. The provision requires firms to:

> report to the regulator or securities regulatory authority… any circumstance where, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with this Instrument, *applicable securities legislation*, or the

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policies and procedures required under section 32 [Policies and procedures].

We believe that market participants should have strong gatekeeper systems to escalate and resolve compliance issues, and that market participants should be *encouraged* to self-report material violations of securities legislation. However, we strongly disagree with the proposed *requirement* for derivatives firms to self-report material non-compliance. We believe that imposing a self-reporting requirement in the business conduct rule greatly exceeds the scope of the Proposed Instrument. If members of the CSA consider it a worthwhile policy objective for market participants to self-report material non-compliance, we would expect each CSA jurisdiction to amend their local securities legislation to this effect, after seeking broad public comment and consulting with stakeholders. Therefore, in the context of NI 93-101, we request that section 34(b) be removed from the instrument.

5. <u>Exemptions from the Application of the Proposed Instrument</u>

a) *Clients and counterparties located outside Canada*

We believe that the CSA should clarify that the requirements in the Proposed Instrument apply only to clients or counterparties located in Canada. Given that non-Canadian derivatives firms would be subject to the Proposed Instrument, we suggest that an exemption should be added to Part 6 [Exemptions] to exclude the application of the Proposed Instrument from transactions between a derivatives firm and a derivatives party where neither are located in Canada. In order to continue to encourage foreign derivatives firms to participate in Canadian derivatives markets, there must be appropriate carve-outs for non-Canadian derivatives trading activities, in order to lessen the burden of compliance with multiple regulatory regimes.

b) *Dealer-to-dealer trading*

Derivatives dealers that engage in trading with other derivative dealers should be subject to Part 5 of the Proposed Instrument [Compliance and Record-Keeping] only in respect of such trading. Similarly, derivatives firms that engage in trading on a swap execution facility or similar platform should also be subject to Part 5 only in respect of such trading. Given that counterparties may be anonymous in trades that occur on an electronic platform, it would not be feasible to require derivatives firms to comply with many of the measures in the Proposed Instrument.

c) *Overlapping derivatives dealer and derivatives adviser requirements*

Where a derivatives adviser provides advice to a client on a non-discretionary basis in respect of a derivatives trade made with a derivatives dealer, we believe that the dealer is

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in the best position to adhere to the business conduct obligations in respect of such trade. In such cases, we submit that many of the requirements in the Proposed Instrument should only apply to the derivatives dealer. In particular, derivatives advisers should be exempt from the requirements in Part 4 of the Proposed Instrument [Derivative Party Accounts], other than sections 20 and 23. This approach would avoid unnecessary redundancy and reduce the burden of compliance.

d) ***End-user exemption***

Although we support the exemption set out in section 39, we regret that it is only applicable to end-users that do not "regularly quote prices at which they would be willing to transact…" There may be a number of large institutional entities that may quote prices frequently enough to fall outside this exemption but that are otherwise end-users. Although such entities do not otherwise act as derivatives dealers or advisers, they would be denied access to the end-user exemption. Respectfully, we would urge the CSA to modify the language of this section so as not to exclude parties that regularly quote prices due to their size or due to a need to regularly hedge positions.

e) ***Exemption for portfolio managers***

We applaud the exemption for registered investment dealers set out in section 41, and we believe that a corresponding exemption for portfolio managers should be added to Part 6, Division 3. We would urge the CSA to ensure that each such exemption covers section 9 [conflicts of interest], section 10 [know your derivatives party], section 12 [suitability], section 13 [permitted referral arrangements], section 16 [disclosure regarding the use of borrowed money], section 17 [handling complaints], section 18 [tied selling], and section 20 [relationship disclosure information].

f) ***Foreign derivatives advisers and dealers***

We support the exemption in Section 44, which exempts foreign derivatives advisers from the application of the Proposed Instrument. Unfortunately, we believe that the exemption is too narrow in its current form. As proposed, in order to benefit from the exemption, the adviser must be *registered* in the foreign jurisdiction where it maintains its head office or principal place of business. This condition is problematic, as it would exclude those derivatives advisers that are exempt from registration in their home jurisdiction or based in jurisdictions without adviser registration requirements (including the U.S.). We therefore believe that the exemption should be amended to include foreign derivatives advisers that are exempt or not required to be registered in their principal jurisdiction, which would also better align with the international adviser exemption in NI 31-103.

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Section 44(2) requires foreign derivatives advisers to maintain compliance with select provisions of the Proposed Instrument. Respectfully, we are concerned that this means of substituted compliance will not be practicable if the foreign derivatives adviser is not subject to a similar form of business conduct regulation in its principal jurisdiction. We therefore urge the CSA to consider an alternative substituted compliance approach for both foreign derivatives advisers and dealers, where compliance with the applicable laws of the dealer or adviser's home jurisdiction (appropriate jurisdictions could be determined by the CSA) suffice for compliance with all aspects of the Proposed Instrument.

Finally, section 44(3)(e) (in respect of foreign derivatives advisers) and section 40(1)(e) (in respect of foreign derivatives dealers) preclude foreign advisers and dealers from relying on exemptions in the Proposed Instrument if "the person or company is… in the business of trading in derivatives on an exchange or a derivative trading facility designated or recognized in the jurisdiction." This limitation would disqualify foreign advisers or dealers that subscribe to designated trading facilities or that are foreign approved participants on the Montreal Exchange. In the absence of a strong policy rationale for including this limitation, we respectfully request that it be struck for both foreign derivatives advisers and foreign derivatives dealers.

* * * *

Thank you for the opportunity to comment on the Proposed Instrument. We would be pleased to discuss our thoughts with you further. If you have any questions or comments, please contact Blair Wiley (416.862.5989 or bwiley@osler.com) or Mark DesLauriers (416.862.6709 or mdeslauriers@osler.com)

Yours very truly,

Osler, Hoskin & Harcourt LLP

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Schedule A:

Specific Questions for Feedback:

1. Definition of "eligible derivatives party"

a) As currently drafted, the definition of "eligible derivatives party" is generally similar to the definition of "permitted client" in NI 31-103, with a few modifications to reflect the different nature of derivatives markets and participants. Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

We believe that all entities that qualify as "permitted clients" under NI 31-103 should likewise be captured by the definition of EDP. Please see our comments above under section 2 of our letter for more detail, and further observations.

b) Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

We agree with the inclusion of individuals as EDPs. Furthermore, we believe that financial assets provide an adequate indication of sophistication. Please see our comments above under section 2 of our letter for more detail.

2. Alternative definition of "eligible derivatives party"

In the CSA Consultation Paper 33-404, it was put forth that certain proposed targeted reforms relating to the client-registrant relationship be tailored in their application to "institutional clients." Proposed targeted reforms relating to suitability and KYC requirements would, for instance, not apply to registrants dealing with an institutional client.

The CSA Consultation Paper 33-404 proposed a definition of "institutional client" which is generally similar to the definition of a "permitted client" in section 1.1 of NI 31-103. However, in comparison to the definition of "permitted client" in NI 31-103 (which refers in paragraph (o) to individuals that beneficially own a specified threshold of financial assets), the definition of "institutional client" in the Consultation Paper did not include individuals. Moreover, in comparison to paragraph (q) of the definition of "permitted client" (which refers to "a person or company, other than an individual or an investment fund, that has net assets of at least $25 million as shown on its most recently prepared financial statements"), the following branch of the definition of "institutional client" proposed in the CSA Consultation Paper 33-404 would establish a higher financial threshold for non-individual entities:

> *(x) any other person or company, other than an individual, with financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $100 million.*

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Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

We believe that the categories of "permitted clients" defined in National Instrument 31-103 form the correct basis for the definition of EDPs. Please see our comments above under section 2 of our letter for more detail.

3. Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"

a) Clauses (m) and (n) of the definition of "eligible derivatives party" provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, "the characteristics of the derivatives to be transacted". The corresponding section of the companion policy notes that "some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type".

If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?

We believe that the knowledge and experience requirement should be removed from the definition of EDP. It is our position that financial assets provide an adequate indication of sophistication, and that section 10 of the Proposed Instrument will ensure that derivatives firms gain sufficient insight into the specific needs and circumstances of their clients.

b) Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

We believe that it is most practical for derivatives firms to determine whether a client qualifies as an EDP independently of any transactions, and then to manage their relationship accordingly. If a derivatives party is an EDP, the derivatives party should be an EDP for all purposes.

4. Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties:

a) Do you agree with the two-tiered approach to investor/customer protection in the Instrument?

We agree with the two-tiered approach. However, as noted in our comment letter, it should be applied for managed accounts, not only dealer activities and non-discretionary advisory activities.

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b) *Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?*

We do not believe that there are any additional requirements that should be imposed.

c) *Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?*

We are generally supportive of the Proposed Instrument, however we have suggested some ways to avoid unnecessarily discouraging trading in OTC derivatives in Canada in our comment letter.

d) *Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?*

Yes. We would ask the CSA to consider striking section 7(3) from the Proposed Instrument.

5. Business trigger guidance

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

Quoting prices or acting as a market maker -- The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if "the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party"

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

We do not believe that the CP provides adequate guidance on this issue, and respectfully request that the language be amended. Please see our comment letter for further detail.

6. Fair Dealing

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

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Yes, we believe that there is a need for a flexible fair dealing model and we would welcome additional guidance on the application of these general requirements.

7. Fair terms and pricing

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

Although we agree with the content of the obligations, we believe that section 19 would be better suited as a part of the CP guidance in respect of section 8 of NI 93-101.

8. Derivatives Party Assets

National Instrument 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party.

Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

We do not believe that Division 2 of Part 4 should apply to EDPs.

9. Valuations for derivatives

a) Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

We are generally supportive of the disclosure requirements contemplated in these sections when the requirements have the effect of increasing transparency for derivatives end-users. In situations where valuations must be provided, we agree that the valuations should be accompanied by information on the inputs and assumptions used.

10. Senior derivatives managers

Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on "senior derivatives managers", and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

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We have concerns with the senior derivatives manager concept, including who would be considered a senior derivatives manager, their reporting lines, proficiency and related issues. Also, we have significant concerns with the proposed self-reporting obligation. Please see section 4 of our letter for more detail.

11. Exemptions

Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

Osler is very supportive of the exemptions for derivatives firms, however we have concerns with the proposal to map equivalent domestic and foreign regulations, which may change over time. Therefore we urge the CSA to consider a broader, results-oriented approach to substituted compliance that allows for exemptions for foreign firms, so long as the home jurisdiction of the foreign firm has a sufficiently rigorous regulatory regime.

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The Canadian Advocacy Council for Canadian CFA Institute Societies
ADVOCATING THE CFA INSTITUTE'S CODE OF ETHICS AND STANDARDS

September 1, 2017

BY EMAIL

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
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Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment - Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (collectively, the "Proposals")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to comment on the Proposals.

[1]The CAC represents more than 15,000 Canadian members of the CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 149,603 members in 163 countries, including 143,386 CFA charterholders and 148 member societies. For more information, visit www.cfainstitute.org.

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We support the Canadian Securities Administrators' (the CSA) efforts in seeking to adopt a harmonized derivatives registration and business conduct regime across Canada. We are supportive of clarifying standards regarding business conduct for participants in the derivatives markets. To the extent rules can also be harmonized with those existing under National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, for example by using similar defined terms, we would encourage the CSA to do so.

While we appreciate the need to build upon existing regulations to minimize market disruption, we agree with the CSA that there are fundamental differences between the securities and the derivatives markets, which in some cases will require a higher investor protection standard. Persons advising and dealing in derivatives must be cognizant of their completely different risk profile, sophistication, and operational requirements from those of conventional securities. Advisers and dealers thus must have a much broader understanding of their clients' business, operations and the associated risks of derivative transactions.

The financial crisis of 2008 highlighted the intrinsic risk of some derivatives products, and questionable business practices by dealers. In addition, recent benchmark manipulation scandals have highlighted unresolved issues. These factors, among others, should warrant the highest level of regulation/protection to investors and the highest level of accountability by registrants.

We may have further comments on the Proposals once we have had an opportunity to review and consider the pending derivatives registration regime.

We wish to provide comments relating to the specific questions in the Proposals as set out below.

1) *Definition of "eligible derivatives party"*

As currently drafted, the definition of "eligible derivatives party" is generally similar to the definition of "permitted client" in NI 31- 103, with a few modifications to reflect the different nature of derivatives markets and participants.

Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

We are generally supporting of the current definition of an "eligible derivatives party" and appreciate the similarities to the existing definition of a "permitted client", which is a well understood term in the market.

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With respect to certain branches of the definition of "eligible derivatives party", we query whether certain governmental institutions (for examples, those listed in (h) and (i)) wouldn't be exempt from the Instrument in any event as commercial counterparties if they use derivatives to hedge currency and interest rate risk only. We also note that many cases have highlighted the information asymmetry that exists between local governments/municipalities and those trading or advising in derivative instruments. Some of these entities might be influenced by short term needs, lack of specific derivatives knowledge and a complicated decision making process, and thus should not qualify as an eligible derivatives counterparty and require additional protection. Further, it may be worth exploring whether parts of the US derivatives regime for special entities and additional protections afforded by them, could also make sense for Canada.

Another category of an eligible derivatives party that might require additional consideration is the branch which would include a securities adviser acting on behalf of a managed account. If such advisers only advised with respect to derivatives on an incidental basis (and thus themselves did not require registration as a derivatives adviser because the business trigger was not satisfied), we query whether qualification as an eligible derivatives party is necessary or appropriate.

We do not have a firm view as to whether individuals should be permitted to qualify as an eligible derivatives party. We have taken the position in the past, with respect to definitions such as the accredited investor definition, that simply possessing investable assets above a certain threshold does not necessary imply financial sophistication, and thus tests based on financial assets (despite the high thresholds) may be insufficient by themselves to determine if a particular person or company has better access to information and require less protection. With respect to an eligible derivatives party, as an example, end users (such as farmers) may attempt to hedge a transaction using commodity forwards or foreign exchange contracts/forwards, and those users may not be experienced with respect to the instruments traded or fully understand what protections they are being asked to waive in their acknowledgement as an individual eligible derivatives party. In this example, such persons in particular would benefit from the market conduct protections available to those who are not eligible derivatives parties. On the other hand, if a sophisticated, individual investor owns a concentrated position in an issuer, they might want to enter into an OTC derivatives transaction for the purpose of disposition by building a bespoke hedging program and reinvesting the proceeds. That individual might not need any additional investor protection as an eligible derivative party who can waive those rights.

Given our views on the different needs of different individual eligible derivative parties, we support the CSA's views that all participants in the derivatives markets would benefit from certain of the proposed market conduct protections that would be available to all market participants. Regulators should have as much flexibility (and enforcement power) as necessary to protect counterparties from issues such as price fixing, manipulation of benchmark rates or front-running of trades, which all may be addressed through the proposed fair dealing requirement in Division 1 of Part 3 of the Instrument.

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2) <u>*Alternative definition of "eligible derivatives party"*</u>

In the CSA Consultation Paper 33-404, it was put forth that certain proposed targeted reforms relating to the client-registrant relationship be tailored in their application to "institutional clients." Proposed targeted reforms relating to suitability and KYC requirements would, for instance, not apply to registrants dealing with an institutional client.

The CSA Consultation Paper 33-404 proposed a definition of "institutional client" which is generally similar to the definition of a "permitted client" in section 1.1 of NI 31-103. However, in comparison to the definition of "permitted client" in NI 31-103 (which refers in paragraph (o) to individuals that beneficially own a specified threshold of financial assets), the definition of "institutional client" in the Consultation Paper did not include individuals. Moreover, in comparison to paragraph (q) of the definition of "permitted client" (which refers to "a person or company, other than an individual or an investment fund, that has net assets of at least $25 million as shown on its most recently prepared financial statements"), the following branch of the definition of "institutional client" proposed in the CSA Consultation Paper 33-404 would establish a higher financial threshold for non individual entities:

(x) any other person or company, other than an individual, with financial assets, as defined in section 1.1 of National Instrument 45-106 Prospectus Exemptions, having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $100 million.

Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

Given the potential for increased market complexity, we do not believe that there are sufficient policy reasons to add another term in order to identify a sophisticated investor. Both entities with $25 million in assets as well as those with $100 million in assets should equally be able to purchase appropriate advice. We feel that $100 million asset threshold in the proposed definition of "institutional client" is arbitrary and very high in the context of Canadian securities and derivatives markets.

3) <u>*Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"*</u>

Clauses (m) and (n) of the definition of "eligible derivatives party" provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, "the characteristics of the derivatives to be transacted". The corresponding section of the companion policy notes that "some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type".

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If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?

Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

We have a broad concern with respect to the requirement to obtain written representations as to the knowledge and experience of an eligible derivatives party, as such a standard evokes ambiguity and may result in uneven application. We note that such a requirement, if implemented, may give rise to impracticalities for a derivatives dealer or adviser to monitor knowledge and experience on an asset class or security type basis. However, in order to deal with potential impracticalities, institutions may categorize their clients based on the type of derivatives they normally trade. It may also be worth exploring the implications from an investor protection standpoint if a person is not limited to being an eligible derivatives party only for the specific type of derivative for which they have the knowledge or experience.

We suggest that a bright-line financial resources test to ascertain the client's degree of knowledge, understanding, level of sophistication or ability to otherwise protect themselves through obtaining expert advice or through contractual negotiation, would be preferable.

4) *Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties*

Do you agree with the two-tiered approach to investor/customer protection in the Instrument? Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

We generally agree with the two-tiered approach in the Instrument, as intuitively persons and companies that do not qualify as an eligible derivatives party could require additional

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protections. We agree the same approach should apply to a derivatives adviser that is advising an eligible derivatives party.

With respect to institutional trading practices, traders such as insurance companies are sophisticated market participants. These derivatives participants understand the risks and common conflicts that are often a part of any derivatives trade, such as the fact that their counterparty trades with other participants. For these type of counterparties, it would be beneficial to receive more customized conflict disclosure shortly before entering a trade that is trade-specific (and likely infrequent), rather than a large boilerplate disclosure document that attempts to deal with all future potential conflicts. In addition, such participants could benefit from additional conflict disclosure once a trade is entered into, if the conflict did not exist at the time of the trade. Examples of conflicts that may need to be disclosed on an ad hoc basis would include matters such as when a dealer becomes an M&A advisor with respect to an issuer that is the subject of an open derivatives position, or becomes a sponsor of an index where there is an open swap position on that index. We understand that in practice, many institutional participants already require such disclosure from their dealers.

We suggest that the CSA ensure that the business conduct requirements for firms dealing with EDPs are consistent with already-existing requirements and avoid any duplication and/or conflict with existing rules.

5) <u>Business trigger guidance</u>

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

Quoting prices or acting as a market maker – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if "the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party".

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

The business trigger guidance is generally easy to understand and helpful in that commercial hedgers should not be required to be registered as derivative dealers, but market makers without commercial interests should be registered. However, in the derivatives markets, unlike the securities markets, trading with regularity (by regularly

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quoting prices at which they would be willing to transact) should not necessarily be a factor in determining whether or not a person is dealing in derivatives. Certain institutional traders, such as pension plans, may by virtue of their size alone be seen as regularly transacting in derivatives, but requiring registration as a derivatives dealer may not be the correct and intended regulatory result. Additional clarity with respect to the factors that will be considered relevant in determining whether a person or company is in the business of trading or advising in derivatives would be welcomed.

6) *Fair Dealing*

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

Yes, the proposed application is appropriate and strikes the right balance for derivative dealers. The term "fair dealing" could be said to imply some flexibility/adaptation in and of itself. It is important to ensure that in its application to parties with different levels of sophistication, the onus of disclosure is not shifted from the registrant to the client, and that registrants have written policies clearly outlining how fair dealing will apply in different circumstances. With respect to derivative advisers, higher standards could be required.

7) *Fair terms and pricing*

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

Yes, the proposed requirements are appropriate. However, it would be beneficial to explicitly include a best execution requirement, as a derivatives dealer should be subject to a requirement to seek and document best execution for its clients, even if the dealer is on the other side of the trade (acting as a principal), which would address a key potential conflict.

8) *Derivatives Party Assets*

National Instrument 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party.

Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

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We understand that issues could develop if all of Division 2 of Part 4 applied to an eligible derivatives party. With respect to the segregation of collateral, we understand that trades for institutional market participants such as pension plans permit full re-hypothecation of collateral (other than initial margin for OTC derivative transactions). If segregation were required, the trades would become more expensive, as dealers currently price the trades on the basis that the collateral can be reused (typically, by both parties to the trade). In addition to increased costs, we understand that little additional protection would be offered with respect to segregation of cash collateral, which would be an intangible in a bank account/ledger which is difficult to identify and individually attribute.

9) Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

Yes, it is quite important that such valuations be accompanied by inputs and assumptions in order to make the estimates/prices more meaningful. The sources and calculation of approximations should also be provided as needed in instances where they are not widely or publicly available, or when they are not based on benchmarks that are similarly widely or publicly available.

10) Senior derivatives managers

Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on "senior derivatives managers", and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

We do not believe the senior management requirements are practical for larger organizations. More specifically, large financial institutions are likely to have more than one "senior derivatives manager", all with board reporting obligations. In addition to the duplication that could ensue, in certain circumstances the senior derivatives manager would be discussing information with the board that may not have been discussed or been brought to the attention of the firm's Chief Compliance Officer (or Ultimate Designated Person), which may complicate the compliance process within a firm. In our view, the role of a "senior derivatives compliance officer" that interfaces with the board could rectify the above-mentioned challenges. Alternatively, it may be worth considering having a position that is comparable to the Ultimate Designated Person in securities law for derivatives that

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would be responsible for relevant compliance reporting and ensure that everyone understands the obligations and best practices regarding derivatives.

In addition, additional clarification on the definition of a "senior derivatives manager" could be helpful.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at chair@cfaadvocacy.ca on this or any other issue in future.

(Signed) *The Canadian Advocacy Council for*
CFA Institute Societies

The Canadian Advocacy Council for
CFA Institute Societies

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asset management group

September 1, 2017

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan)
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Re: Comments with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**")[1] appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the ***Instrument***) and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the ***CP*** and, collectively with the Instrument, the ***Proposed Rule***). The Proposed Rule was published on April 4, 2017 and contemplates a harmonized business conduct regime for OTC derivatives across Canada.

The Proposed Rule would have a significant impact on AMG members, including many that provide asset management services to Canadian clients on a cross-border basis. The full impact of the Proposed Rule is hard to assess absent further details on the proposed registration regime for derivatives advisers which has not yet been released for comment[2]. Given the overlap between

[1] SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset management firms whose combined global assets under management exceed USD $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

[2] Proposed National Instrument 93-102 *Derivatives: Registration* (the "**Registration Proposal**").

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business conduct standards and registration, SIFMA AMG may have additional feedback on the Proposed Rule once the CSA's registration proposal for derivatives advisers is made available for public comment.

A. General Comments:

1. Most Business Conduct Requirements Should Only Apply to Dealers

SIFMA AMG strongly believes that most of the requirements in the Proposed Rule that apply to both derivatives dealers and derivatives advisers should only apply to derivatives dealers. When an adviser enters into an OTC derivatives transaction on behalf of a client, the transaction is between the client and the executing derivatives dealer. Given that the client is facing the derivatives dealer as principal, there is no need for additional and duplicative business conduct requirements to apply in respect of the transaction simply because the counterparty is represented by an adviser. In particular, we think dealers alone should be subject to the requirements with respect to fair dealing (especially sections 8(1) and (2)), disclosure regarding borrowed money and leverage (section 16), daily reporting (section 22) and statements (section 30). Dealers are best positioned to undertake these responsibilities and the imposition of the same requirements on asset managers would create a duplicative and unnecessary compliance burden.

2. Broad Foreign Adviser Exemption is Required to Minimize Overlapping Rules

SIFMA AMG supports the exemption in section 44 of the Proposed Rule for foreign derivatives advisers whose head office or principal place of business is not in Canada. In the case of the United States, we submit that advisers that are registered with either the Securities and Exchange Commission or the Commodity Futures Trading Commission to provide advice in respect of securities or derivatives or which are otherwise authorized under applicable United States law to provide such advice to persons in the United States should be eligible for the exemption contemplated in section 44.

Subsection 44(3)(a) of the Proposed Rule makes the foreign adviser exemption unavailable unless the adviser is registered in the foreign jurisdiction in which it has its head office or principal place of business. SIFMA AMG submits that the exemption should be available to foreign derivatives advisers that are either exempt from registration or are not required to be registered to act as an adviser in their home jurisdiction. We also submit that these foreign advisers should not have to obtain a separate Canadian exemption from registration in order to be exempt from the business conduct standards in the Proposed Rule. We recommend that the CSA amend Section 44 to reflect this approach and allow foreign firms that comply with the applicable rules of their home jurisdiction to take advantage of the exemption in Section 44 even if they are not registered in the foreign jurisdiction.

We note that the exemption for foreign advisers in Section 44 of the Proposed Rule is not available where the adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. We submit that this restriction should not be necessary and ask the CSA to explain why trading on such an exchange or derivatives trading facility (as an adviser on behalf of clients or otherwise) should make the adviser ineligible for the foreign adviser exemption.

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In addition, we believe the exemption in section 44 should be available to foreign advisers that advise both eligible derivatives parties ("EDPs") and non-EDPs. We see no reason why the availability of the exemption should be based on the type of client that is being advised and submit that sub-section 44(1)(a) of the Proposed Rule should be amended accordingly.

As contemplated, the foreign adviser exemption is only available to a derivatives adviser that complies with equivalent foreign laws which will be identified in an appendix to the final rule. In order for SIGMA AMG's members to assess this element of the proposed foreign adviser exemption, it is critical to understand which foreign jurisdictions will be identified in Appendix D to the Proposed Rule and what, if any, residual requirements will apply for each specified jurisdiction. We request that the CSA publish the list of jurisdictions and any applicable residual provisions for consultation in advance of finalizing the Proposed Rule so that our members can provide feedback.

Finally, SIFMA AMG respectfully requests that, in situations where a foreign adviser does not qualify for an exemption from the application of the requirements of the Proposed Rule, the CSA clarify that the requirements contemplated in the Proposed Rule would apply to advisory services provided by our members only to clients located in Canada or organized under Canadian law.

3. ***General Advisory Duties Should not be Duplicated in Proposed Rule***

SIFMA AMG does not think a compelling rationale has been provided for requiring separate business conduct standards for advisers solely in connection with derivatives advisory activities. We believe the Proposed Rule imposes duplicative requirements that will increase the compliance burden on advisers without any clear benefits. We are concerned that the Proposed Rule will complicate compliance with well-established fiduciary standards and practices observed by advisers in the context of derivatives and other investing activities. For example, we believe the requirements in the Proposed Rule with respect to conflicts of interest (section 9) and suitability (section 12) already apply to advisers as part of their contractual arrangements with clients and the fiduciary duties that advisers owe to clients under common law. Similarly, we do not see the benefit of requiring specific "know your derivatives party" policies and procedures as contemplated in Section 10(2) of the Proposed Rules; it is general practice for advisers to fulfill appropriate KYC requirements when establishing an advisory relationship and executing an investment management agreement.

To the extent business conduct requirements will apply to advisers which are required to register under the Registration Proposal, we think the CSA should consider amending the relevant provisions of National Instrument 31-103 ("NI 31-103") as appropriate to specifically address derivatives, as opposed to introducing a new set of requirements applicable to all advisers along the lines of the Proposed Rule.

4. ***Deviations from International Standards Will Harm Cross-Border Activity***.

A number of the proposed requirements are inconsistent with the regulatory framework applicable to advisers in other major markets like the United States. We are concerned that the regulatory burden associated with these new requirements will reduce the number of foreign advisers willing to provide advisory services to Canadian clients. The proposed senior managers regime is a good example of this. Foreign advisers with a small number of Canadian clients will be reluctant to incur the cost and complexity of implementing such a regime solely for Canadian activity. Similarly, the

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recordkeeping requirements in Part 5 of the Proposed Rule are more onerous than the recordkeeping requirement imposed on advisers in major jurisdictions like the United States. Among other things, the Proposed Rule requires records to be maintained for much longer than in other jurisdictions. The significant investment in technology, systems and compliance infrastructure to meet these recordkeeping requirements will be a disincentive to maintaining advisory relationships with Canadian clients. SIFMA AMG asks the CSA to consider whether a sufficient benefit has been identified to justify these significant burdens and costs for market participants.

B. *Specific Comments*:

1. Derivatives Adviser Definition – Business Trigger Factors

SIFMA AMG would ask the CSA to reconsider the factors listed in the CP for determining whether a party is in the business of advising in respect of derivatives. For one, we do not believe the same list of factors should apply for both dealers and advisers. Many of the factors in the CP, such as quoting prices, are never relevant to advisers. Other factors, such as "engaging in activities similar to a derivatives adviser or derivatives dealer", are too open-ended and will make it very difficult to determine and obtain definitive legal advice as to who qualifies as a derivatives adviser.

To avoid any ambiguity, SIFMA AMG believes that the definition of derivatives adviser (and the related portions of the CP) should be amended to expressly exclude (i) professionals whose advisory services are solely incidental to their business or profession (e.g., lawyers, accountants), (ii) otherwise-regulated persons, including derivatives dealers (whether registered or exempt from registration), banks, trust companies and regulated insurance companies and (iii) pension plan sponsors and their affiliates that are providing investment-related services to a Canadian regulated pension fund or subsidiary thereof. Alternatively, these three classes of persons should be exempted from the application of the Proposed Rule.

SIFMA AMG strongly agrees with the inclusion of section 4 of the Proposed Rule, which effectively exempts a person providing derivatives advisory services to an affiliated entity from the Proposed Rule. We submit that the provision should be expanded to exempt the person providing investment advisory services for no compensation to an associated or related person that does not otherwise fall within the definition of affiliated entity for purposes of the Proposed Rule. Alternatively, guidance could be included in the CP to provide clarity that a person providing derivatives advisory services to an associated or related person for no compensation would not trip the "business trigger" for purposes of the definition of "derivatives adviser".

We further submit that it would be helpful to have guidance that a person acting as a manager of investment managers providing derivatives advisory services will not be considered a "derivatives adviser" for purposes of the Proposed Rule solely on the basis that the manager is engaged in hiring, and providing investment guidelines to, third party investment managers.

2. EDP Definition

SIFMA AMG believes it is important that the definition of "eligible derivatives party" include all persons and entities that qualify as "permitted clients" under NI 31-103. While there are differences between the securities and derivatives markets, we do not believe a justification has been identified for excluding any category of "permitted client" from the definition of EDP. Many of SIFMA

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AMG's members have already obtained "permitted client" representations from their Canadian clients. If all permitted clients are not also EDPs, our members will have to undertake a significant outreach effort to confirm the status of their Canadian clients for purposes of the Proposed Rule. We submit that such a significant outreach effort is not justified and that the definition of EDP should be drafted in way that allows dealers and advisers to rely on existing representations from their clients as to their status.

SIFMA AMG believes that individuals with minimum net assets of $5 million should be treated as EDPs. We believe a standard based on minimum assets is an adequate indicator of sophistication and provides an objective way for determining which individuals qualify as EDPs. SIFMA AMG does not believe a specific knowledge and experience requirement should apply in order for individuals to qualify as EDPs. We also do not believe that the waiver contemplated in section 7(2) of the Proposed Rule is necessary for individuals who meet the minimum asset test. If the CSA decide to preserve this waiver requirement in the final rule, we submit that it should be a one-time requirement and that the onus should be on the individual to send a revocation notice to their dealer or adviser in the event they want to revoke a previously granted waiver.

SIFMA AMG also believes the two-tiered approach should apply to derivatives advisers when they are advising with respect to managed accounts. We do not support the approach in Section 7(3) of the Proposed Rule which would require derivatives advisers to apply all the requirements of the Proposed Rule for managed account of EDPs. EDPs are sophisticated investors who should not be treated like non-EDPs simply because they have granted discretionary authority to an adviser to execute derivative transactions on their behalf. The need for additional disclosures and protections is no different where the trading decision is client-directed versus at the discretion of an adviser. At a minimum, EDPs receiving advisory services through a managed account should be permitted to waive application of the full set of business conduct requirements in the Proposed Rule so that they are treated like EDPs whose trading decisions are self-directed.

3. *Know Your Derivatives Party*

While we do not believe specific KYC policies and procedures are necessary for derivatives advisers, we would like to highlight section 10(2)(c) of the Proposed Rule as particularly problematic. Section 10(2)(c) would require derivatives advisers, in connection with securities based derivatives, to establish if the party they are advising (i) is an insider of a reporting issuer or any other issuer whose securities are publicly traded or (ii) would be reasonably expected to have access to material non-public information (MNPI) relating to any interest underlying the derivative. While it may make sense to require this information in the context of securities trading, we do not see why this information should be required for derivatives. Given that derivatives (including index based products) can reference many different underling issuers, it would not be practicable for an adviser to collect this information and keep it current. It is also unclear if this information regarding possession of MNPI would need to be assessed each time a derivative referencing an underlying issuer is entered into.

4. Derivative Party Assets

While we agree that advisers should be required to segregate client assets from the adviser's own assets, the Proposed Rule is overbroad in how it would restrict advisers. As part of their discretionary mandate, advisers are generally given authority by their clients with respect to the use

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and investment of assets (both in relation to derivatives trading and other activities). For example, advisers are often given authority to post client assets with third parties to margin derivatives transactions. The third party generally has a right of rehypothecation over that collateral under the terms of the relevant credit support documentation. We would ask the CSA to clarify this part of the rule so that advisers are not restricted from fulfilling their discretionary mandates in unforeseen ways.

5. *Referral Arrangements*

In connection with advisory mandates involving derivatives, advisers are often instructed by their clients to identify dealer counterparties and negotiate terms under which the adviser can trade with that dealer on behalf of the client. We would ask the CSA to clarify in the Proposed Rule that establishing a relationship with a dealer on behalf of an advisory client does not constitute a referral arrangement for purposes of the Proposed Rule.

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We would be happy to further discuss the issues identified herein at your convenience. If you have any questions, please contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, or Laura Martin at 212-313-1176 or lmartin@sifma.org, or Darren Littlejohn at 416-863-4348 or darren.littlejohn@blakes.com

Respectfully submitted,

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