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CSA Notice and Second Request for Comment

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

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

June 14, 2018

Introduction

We, the Canadian Securities Administrators (the **CSA** or **we**), are publishing the following for a second comment period of 95 days, expiring on September 17, 2018:

- 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.

In developing the Proposed Instrument, the CSA has consulted with the Bank of Canada, the Office of the Superintendent of Financial Institutions (**OSFI**) and the Department of Finance (Canada). We intend to continue to consult with these entities throughout the development of the Proposed Instrument.

On April 19, 2018, we published for comment Proposed National Instrument 93-102 D*erivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (collectively, the **Proposed Registration Instrument**). The Proposed Instrument, together with the Proposed Registration Instrument, are intended to implement a comprehensive regime for the regulation of persons or companies that are in the business of trading or advising on derivatives. Accordingly, we are overlapping the comment period for the Proposed Instrument with that of the Proposed Registration Instrument, which will also close on September 17, 2018. This will allow commenters to consider the Proposed Instrument and the Proposed Registration Instrument together when making their comments.

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Background

In April 2013, the CSA published for comment CSA Consultation Paper 91-407 *Derivatives: Registration* which outlined a proposed registration and business conduct regime for derivatives markets participants.

On April 4, 2017, we published for comment Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the **first consultation**). The comment period for the first consultation closed on September 1, 2017. During the comment period, we received submissions from 21 commenters. We thank all commenters for their input. We have carefully reviewed the comments received and have revised the Proposed Instrument. The names of the commenters and a summary of their comments, together with our responses, are contained in Annex A of this Notice. Copies of the submissions on the Proposed Instrument can be found on the websites of the Alberta Securities Commission,[1] Ontario Securities Commission[2] and Autorité des marchés financiers.[3]

As we indicated in the CSA Notice that accompanied the first consultation, we have chosen to split the proposed derivatives registration and business conduct regime into two separate rules. This approach simplifies each rule and is intended to ensure that all derivatives firms (i.e., all derivatives advisers and all derivatives dealers) remain subject to certain minimum standards in all Canadian jurisdictions.

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, increase accountability and promote responsible business conduct in the over-the-counter (**OTC**) derivatives[4] 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."[5] Moreover, 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 front-running of customer orders.

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[1] Available at http://www.albertasecurities.com/Regulatory%20Instruments/5341884-v1-CSA_Notice_and_Request_for_Comment_NI_93-101.PDF

[2] Available at http://www.osc.gov.on.ca/en/55181.htm

[3] Available at https://lautorite.qc.ca/en/professionals/regulations-and-obligations/public-consultations/topic/derivatives/finished/

[4] The Proposed Instrument applies to derivatives as determined in accordance with the product determination rule applicable in the relevant jurisdiction. 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. Only those OTC derivatives set out in the applicable product determination rule are relevant.

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

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To address these issues, the Proposed Instrument, together with the Proposed Registration 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.[6] As a result, the Proposed Instrument will help protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and foster confidence in the Canadian derivatives markets.

The Proposed Instrument is intended to create a uniform approach to derivatives markets conduct regulation in Canada and promote consistent protections for market participants regardless of the type of firms they deal with, while also providing that derivatives dealers and advisers operating in Canada are subject to consistent regulation that does not result in any competitive disadvantage.

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, a test is used to determine if the person or company is in the business of trading or advising in OTC derivatives. Nevertheless, a person or company that may be in the business of trading in OTC derivatives may be exempt from the requirements of the Proposed Instrument if they qualify for the end-user exemption. 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 derivatives dealer's or derivatives adviser's derivatives party.

The Proposed Instrument sets out a comprehensive approach regulating the conduct of derivatives markets 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 derivatives 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

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

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- certain obligations:
  - do not apply if the derivatives firm is dealing with or advising a derivatives party that is an "eligible derivatives party" and is neither an individual nor a specified commercial hedger, and
  - apply but may be waived if the derivatives firm is dealing with or advising a derivatives party who is an "eligible derivatives party" that is an individual or a specified commercial hedger.

The definition 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 below in Part 1 of the Summary of the Instrument.

As explained in CSA Staff Notice 33-319 *Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*, the CSA are presently considering a number of proposals aimed at strengthening the obligations that securities advisers, dealers and representatives owe to their clients. CSA staff responsible for this initiative continue to develop these proposals. We will monitor the work on this project, and may recommend amendments to the Proposed Instrument at a later date based on this work.

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 provided below.

Derivatives adviser and derivatives dealer

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

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 markets 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.

Paragraph (b) in the definitions of each 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).

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Derivatives party

In the 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. It is not necessary that the parties consider a client relationship to exist in order for one party to be a derivatives party to the other.

Eligible derivatives party

The term "eligible derivatives party" is intended to refer to those sophisticated derivatives parties that do not require the full set of protections afforded to "retail" customers or investors, either because they may reasonably be considered to have sufficient knowledge and experience to assess the risks of transacting in derivatives or because they have sufficient financial resources to obtain professional advice in order to protect themselves through contractual negotiation with the derivatives firm.

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.[7] In addition, the definition is similar to the definition of "permitted client" in NI 31-103, with a few modifications intended to reflect differences between derivatives and securities markets.

Specified commercial hedger

The term "specified commercial hedger" refers to a commercial hedger that meets the conditions under either paragraph (n) or (q) of the definition of eligible derivatives party.

Part 2 – Application

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 allow the Instrument to apply in respect of 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 a specified commercial hedger, or

[7] 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 "qualified party" in Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*, the definition of "qualified party" in Manitoba Blanket Order 91-501 *Over-the-Counter Trades in 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* and the definition of "qualified party" in Nova Scotia Blanket Order 91-501 *Over The Counter Trades in Derivatives*.

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- is an individual or specified commercial hedger that has waived in writing the protections provided by the requirements.

An eligible derivatives party that is neither an individual nor a specified commercial hedger, or is an individual or specified commercial hedger that has waived these protections in writing, is referred to as a **specified eligible derivatives party** in this Notice.

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 23 [*Interaction with other instruments*] and 24 [*Segregating derivatives party assets*] of Part 4 [*Derivatives party accounts*];

(c) subsection 27(1) [*Content and delivery of transaction information*] of Part 4 [*Derivatives party accounts*]; and

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

A derivatives firm and an 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 an eligible derivatives party, these protections should not be required but rather should be a matter of contract for the parties.

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

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 the 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 markets participants' reasonable expectations. We expect that the fair dealing obligation 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 markets participants' reasonable expectations. Furthermore, it is expected that in responding to any conflict of interest, the derivatives party will consider the fair dealing obligation 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 are intended to protect non-eligible derivatives parties. They do not apply to the extent that a derivatives firm is dealing with or advising a specified eligible derivatives party.

A description of a number of these obligations is provided below.

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 provide the appropriate pre-transaction disclosure under subsection 19(1).

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Information on a derivatives party's specific needs and objectives (sometimes referred to as "client-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 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.

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. 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 17 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 17 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.

Part 4 – Derivatives Party Accounts

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The CSA believe that less sophisticated derivatives parties, or those individuals who may require 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 18 requires a derivatives firm to provide a derivatives party with all information that the derivatives party needs in order 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.

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Subsection 18(1) sets out the obligation for a derivatives firm to provide a derivatives party with disclosure 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.

This section also 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. The risk disclosure requires an explanation that borrowing money or using leverage to fund a derivatives transaction carries additional risk.

In addition, subsection 19(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 19(1), and

- if applicable, to set out the price of the derivative to be transacted and the most recent valuation.

Further to these obligations, section 20 requires a derivatives firm to provide a derivatives party with a 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 collateral delivered to a derivatives firm as initial margin, and imposes a requirement on the derivatives firm to obtain the written consent of its derivatives party if the derivatives firm intends to use or invest the collateral that is delivered to it by or for a derivatives party.

The Instrument exempts a derivatives firm from this Division in respect of derivatives party assets if, in respect of those derivatives party assets, any of the following apply:

- 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*,

- the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds* (**NI 81-102**).

We expect that later this year, securities legislation relating to margin and collateral requirements will be published for comment in *Proposed National Instrument 95-101 Margin and Collateral Requirements for Non-Centrally Cleared Derivatives*.

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The obligations in this Division, other than section 23 and section 24, 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 27 provides that a derivatives firm must provide its derivatives party with a confirmation of the key elements of a derivatives transaction. If the derivatives party is not a specified eligible derivatives party, the required contents of this confirmation are set out in subsection 27(2).

Section 28 sets out the obligations of a derivatives firm to provide quarterly statements to derivatives parties. Subsection 28(2) describes the information that must be provided in the quarterly statement.

The obligations in this Division, other than the fundamental transaction confirmation requirement in subsection 27(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 30 provides that a derivatives firm must have policies, procedures and 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.

The CSA are monitoring international regulatory initiatives designed to ensure that senior managers bear responsibility for the effective and efficient management of their business units. Section 31 imposes certain supervisory, management, and reporting obligations on "senior derivatives managers". These requirements are intended to create accountability at the senior management level. A senior derivatives manager is an individual designated by the derivatives firm as responsible for the derivatives business unit of the derivatives firm. Senior derivatives managers must supervise compliance activities and respond, in a timely manner, to any material non-compliance by an individual working in the derivatives business unit. Furthermore, a senior derivatives manager or a chief compliance officer who has been delegated the responsibility must also report at least annually to the firm's board of directors, either to specify each incidence of material non-compliance with, or to specify that each derivatives business unit is in material compliance with, the Instrument, applicable securities legislation and the policies and procedures required under section 30.

Section 32 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.

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Part 6 – Exemptions

DIVISION 1 – EXEMPTION FROM THE INSTRUMENT

End users

Section 37(1) provides that certain 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 42;
- regularly 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 other than an affiliated entity that is not an investment fund;
- facilitate the clearing of a transaction in a derivative through the facilities of a qualifying clearing agency for another person or company.

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

Foreign derivatives dealers and foreign derivatives advisers

Divisions 2 and 3 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 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.

Investment dealers

Division 2 provides an exemption from requirements in the Instrument for a derivatives dealer that is a dealer member of the Investment Industry Regulatory Organization of Canada (**IIROC**) if the derivatives dealer complies with the corresponding conduct and other regulatory requirements of IIROC as set out in Appendix B of the Instrument.

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Canadian financial institutions

Division 2 provides an exemption from requirements in the Instrument for a derivatives dealer that is a Canadian financial institution and is subject to and complies with corresponding conduct and other regulatory requirements of its prudential regulator as set out in Appendix C of the Instrument.

Note that, as of the time of this publication for comment, the equivalency analysis required to populate the Appendices of the Instrument has not been completed. The Appendices will be completed and published for public comment prior to the Instrument being finalized.

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.

Part 8 – Effective Date

Section 45 provides that the requirements will not apply to unexpired derivatives that were entered into before the effective date of the Instrument other than the following ongoing requirements: fair dealing (Section 8), daily reporting (Section 20) and derivatives party statements (Section 28).

Summary of Key Changes to the Proposed Instrument from Previous Publication

(a) "eligible derivatives party" new paragraph (o) – commercial hedger

We received a number of comments relating to the net asset requirement of $25 million for a person or company to be considered an eligible derivatives party under paragraph (m) of that definition. Commenters expressed the view that this threshold may reduce liquidity for commercial hedgers and is not harmonized with the threshold in other major trading jurisdictions. In response to these comments, we have included a new paragraph of the eligible derivatives party definition for commercial hedgers that have at least $10 million in net assets and meet other specified conditions. Entities relying on this paragraph must waive their right to be treated as a non-eligible derivative party.

(b) "eligible derivatives party" new paragraph (p) – fully guaranteed entities

We received comments that the eligible derivatives party definition should be amended to allow an entity to qualify as an eligible derivatives party if its obligations are guaranteed by an entity that otherwise qualifies as an eligible derivatives party. In response to these comments we have included a new paragraph (p) of the eligible derivatives party definition for companies whose obligations under a derivative are fully guaranteed or otherwise fully supported under an agreement by one or more eligible derivatives parties.

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(c) Managed accounts of eligible derivatives parties

We received a number of comments recommending that managed accounts for eligible derivatives parties should not be treated like those of non-eligible derivatives parties. They asserted that eligible derivatives parties are sophisticated investors and the fact that they have granted discretionary authority to an adviser to execute derivative transactions on their behalf should not change that classification. In response to these comments, we have removed subsection 7(3) which required managed accounts of eligible derivatives parties to be treated as those of non-eligible derivatives parties.

(d) Former section 19 – Fair terms and pricing

We received comments that the former section 19 fair terms and pricing provision was not appropriately tailored for the OTC derivatives market. The commenters pointed out the negotiated, bilateral and bespoke nature of OTC derivatives transactions. We received another comment that this provision would be better suited as part of the fair dealing obligation in section 8 of the Instrument. In response to these comments, we have deleted this provision and included companion policy guidance in section 8 relating to the pricing of derivatives.

(e) Part 4, Division 2 – Derivatives Party Assets

We received a number of suggestions to revise this Division, relating to the scope of its application generally and to the re-use and investment of derivatives party assets. Part 4 Division 2 now clarifies that this requirement does not apply to a derivatives firm's transactions with a derivatives party that are already subject to rules that apply to a specific type of derivatives party, such as securities legislation relating to margin and collateral requirements or NI 81-102. Furthermore, this Division imposes a requirement on the derivatives firm to obtain the written consent of its derivatives party if the derivatives firm intends to use or invest initial margin.

(f) Part 5, Division 1 – Compliance

We received comments that certain of the senior derivatives manager obligations, such as compliance reporting to a derivatives firm's board of directors, should be undertaken by a firm's chief compliance officer and not its senior derivatives manager. We have amended sections 31 and 32 to permit the senior derivatives manager or a chief compliance officer to fulfil the internal reporting requirements.

(g) Sections 38 and 43 – Foreign derivatives dealer exemption and foreign derivatives adviser exemption – trading on an exchange or derivatives trading facility

We received comments that the exemption for foreign derivatives dealers and foreign derivatives advisers should be available to foreign dealers and foreign advisers in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. In response to these comments, we have amended subsections 38(3) and 43(3) so that these foreign derivatives dealers and foreign derivatives advisers are no longer prohibited from qualifying for the exemptions under sections 38 and 43.

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(h) Section 41 – Derivatives traded on a derivatives trading facility that are cleared

We received comments that a derivatives firm may not know the identity of its derivatives party prior to execution of a transaction anonymously on a derivatives trading facility. We have included an exemption from sections 10 and 27 of the Instrument for derivatives traded on a derivatives trading facility that, as soon as technologically practicable, are submitted for clearing to a qualifying clearing agency. This exemption is only available if the derivatives firm's derivatives party is an eligible derivatives party.

(i) Section 45 – Effective date

We received a number of comments that market participants should be permitted to leverage existing disclosures and representations to determine eligible derivatives party status. In response to these comments, we have included a transition provision that permits derivatives firms to rely on a derivatives party's "permitted client" status under National Instrument 31-103, "accredited counterparty" status under the *Derivatives Act* (Quebec) or "qualified party" status under the relevant blanket orders in the provinces of Alberta, British Columbia, Manitoba, New Brunswick or Nova Scotia for transactions entered into prior to the coming into force of the Instrument. However, the fair dealing obligation, daily reporting and derivatives party statement requirements will apply to these pre-existing transactions.

(j) International harmonization and miscellaneous drafting clarifications

There are a number of drafting changes throughout the Instrument to respond to comments that clarify the Instrument and further harmonize the Instrument with international regulatory regimes.

Anticipated Costs and Benefits

As mentioned above, we have developed the Proposed Instrument to help protect investors and counterparties, reduce risk, improve transparency, increase accountability and promote responsible business conduct in the OTC derivatives markets. Moreover, the business conduct requirements under the Instrument will help to protect participants in the OTC derivatives markets from unfair, improper or fraudulent practices and foster confidence in the Canadian derivatives market.

The Proposed Instrument aims to provide participants in the Canadian OTC derivatives markets with protections that are equivalent to protections offered to participants in other major international markets.

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 markets by reducing the likelihood of suffering loss through inappropriate transactions, inappropriate sale of

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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 markets for certain derivatives firms that are not subject to business conduct regulation and oversight. It is intended to foster confidence in the Canadian derivatives markets by creating a regime that meets international standards and is, where appropriate, 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 to the degree possible, by harmonizing the rules across Canadian jurisdictions and establishing a regime that is tailored for the derivatives market.

(b) Costs

Generally, firms will incur costs from analysing the requirements 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 Instrument contemplates a number of exemptions, including an exemption for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent requirements under foreign laws. These exemptions could significantly reduce compliance costs associated with the Proposed Instrument for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

(c) Conclusion

The CSA are of the view that the impact of the Proposed Instrument, including anticipated compliance costs for derivatives firms, is proportional to the benefits sought.

Protection of derivatives parties and the integrity of the Canadian derivatives markets are the fundamental principles of the Proposed Instrument. 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, while being tailored to the nature of the Canadian market. To achieve a balance of interests, the Proposed Instrument is designed to promote a safer environment in the Canadian derivatives markets while offering exemptions to derivatives firms that only deal with eligible derivatives parties or that are already subject to and compliant with equivalent requirements.

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Contents of Annexes

The following annexes form part of this CSA Notice:

- Annex I – Summary of comments and CSA responses and list of commenters
- Annex II – Proposed National Instrument 93-101 *Derivatives: Business Conduct*
- Annex III – Proposed Companion Policy 93-101 *Derivatives: Business Conduct*
- Annex IV – Alternative version of the definition of "affiliated entity"
- Annex V – 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 "affiliated entity"

The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

2) Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

3) Anonymous transactions executed on a derivatives trading facility

We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption?

We are also considering whether a similar exemption should be available in other scenarios, including, for example:

(a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and

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(b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency.

Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

4) Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

5) Derivatives Party Assets

We note that the requirements with respect to initial margin in sections 25 and 26 only apply to transactions with non-EDPs. Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.

6) Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.[8]

Please provide your comments in writing by **September 17, 2018**.

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.

[8] Staff in British Columbia are particularly concerned about the scope of this requirement, in its current form.

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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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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 • an EDP that is a specified commercial hedger 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]**; 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]**; section 39A of the *Securities Act* (Nova Scotia), R.S.N.S. 1989, c. 418 **[N.S. 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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Obligation	Approach under NI 31-103	Approach under NI 93-101
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). Additionally, this does not apply to an anonymous transaction executed on a derivatives trading facility that is cleared.
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 • an EDP that is a specified commercial hedger that has waived 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 • an EDP that is a specified commercial hedger that has waived this obligation (ss. 7 and 19)
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)	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

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Obligation	Approach under NI 31-103	Approach under NI 93-101
	• 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	• an EDP that is a specified commercial hedger that has waived this obligation (See ss. 7 and Part 4)

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Appendix B

Application of business conduct requirements

Regulatory Requirement	**Derivatives firms dealing with EDPs**	**Derivatives firms dealing with non-EDPs**
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 • Complaint handling • Prohibition on tied selling		●
Client and counterparty accounts (Part 4) • Relationship disclosure • Pre-trade disclosures re. leverage/borrowing, 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] • Quarterly statements		●
Compliance and recordkeeping (Part 5) • Compliance and risk management systems • Senior manager report • 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

COMMENT SUMMARY AND CSA RESPONSES

Section Reference	Summary of Issues/Comments	Response
Part 1 – Definitions and Interpretation		
s. 1 – Definition of "derivatives adviser"	Two commenters noted the compliance requirements of National Instrument 31-103 *Registration Requirements and Exemptions* ("NI 31-103") and suggested the Instrument would be duplicative.	Many of the requirements in the Proposed Instrument are similar to existing business conduct requirements applicable to registered dealers and advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets. In the case of firms that are registered under NI 31-103, we would expect these firms to have policies and procedures in place aimed at complying with these obligations. To the extent compliance requirements under the Instrument are similar to compliance requirements under NI 31-103, a registered firm will be able to satisfy the requirements through its existing policies and procedures. However, to the extent compliance requirements are dissimilar, these firms will need to adopt additional policies and procedures that reflect the different nature of derivatives markets.
	One commenter suggested that the list of factors for determining whether a party is in the business of advising in respect of derivatives should not be the same as that for trading.	Change made. The CP has been revised to include additional guidance on the business trigger for advising. See revised CP guidance on factors in determining a business purpose – derivatives advisers.

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s. 1 – Definition of "derivatives dealer"	One commenter requested clarification on which agency roles fall within the scope of the definition.	Change made. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer. See revised CP guidance on factors in determining a business purpose – derivatives dealer.
	One commenter suggested the definition of derivatives dealer be harmonized across Canada into a national instrument.	No change. The definition of derivatives dealer and the criteria used to assess if a firm is a derivatives dealer found in the CP to this Instrument will be applied consistently across Canada and in Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed NI 93-102**"). To the extent necessary, any further consequential amendments to other rules, such as rules relating to trade reporting, will be made at a later date.
s. 1 – Business trigger to "derivatives adviser" and "derivatives dealer", General	Two commenters requested clarification of the definition of "derivatives adviser" and "derivatives dealer" to enable derivatives parties to receive definitive legal advice on whether their activities bring them into scope.	Change made. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser.
	Two commenters suggested replacing the word "trading" with "dealing" in the definition and CP guidance on "derivatives dealer".	No change. The registration requirement in Canadian securities legislation is generally based on the concept of a "business trigger" for registration, namely whether a person or company is in the business of "trading" securities or derivatives or advising others in relation to securities or derivatives.
	Two commenters requested clarification of the jurisdictional scope of the Instrument and CP.	Changes made. The CP has been revised to include guidance on the jurisdictional scope of the Instrument under factors in

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		determining a business purpose – general.
	One commenter requested a specific exemption or guidance that investment-related services provided by pension plan sponsors to their sponsored plans, such as hiring third party investment managers, is not captured. The commenter submitted that the inclusion of "directly or indirectly carrying on the activity with repetition, regularity or continuity" and "transacting with the intention of being compensated" may capture pension plans or their sponsors.	No change. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser. The registration requirement in Canadian securities legislation is generally based on the concept of a "business trigger" for registration, namely whether a person or company is in the business of trading securities or derivatives or advising others in relation to securities or derivatives. Accordingly, the Instrument does not fundamentally alter the nature of the existing registration requirement for market participants, but merely extends the requirement to OTC derivatives. If a firm, after considering the guidance in the CP, remains uncertain as to whether or not it has tripped the business trigger for registration, the firm should consider the exemptions in Part 6 of the Instrument, including the exemption in s. 37 for certain derivatives end-users.
	One commenter requested guidance that a person acting as a manager of investment managers providing derivatives advisory services will not be considered a "derivatives adviser" solely on the basis of engaging in hiring, and providing investment guidelines to, third-party investment managers.	No change. The revised CP provides additional guidance on when a person or company will be considered to be a derivatives dealer or a derivatives adviser. The Instrument and Proposed NI 93-102 do not contemplate a separate category of registration

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		for fund managers of funds that invest in derivatives. However, the existing registration category of investment fund manager in NI 31-103 would likely cover these activities.
s. 1 – Business trigger to "derivatives adviser" and "derivatives dealer", Routinely quotes prices	Several commenters suggested that routinely providing quotes should not be treated as indicia of dealing or advising. The commenters suggested that "derivatives dealer" be limited to market making activity, which absent other factors, should not be determined solely by quoting prices, routinely or not. The commenters requested clarification of the end-user exemption.	Partial change. Further revisions have been made to the indicia described in the CP to determine whether a derivatives dealer or derivatives advisor is in the business of trading derivatives. The CP explains that the end-user exemption may be available to a party that trades derivatives with regularity but does not engage in specified dealer-like activities.
s. 1 – Business trigger to "derivatives adviser" and "derivatives dealer", Derivatives clearing services	One commenter requested clarification of clearing services that would result in a clearing broker being considered a "derivatives dealer".	No change. Providing clearing services is one of the indicia of being in the business of trading derivatives.
s. 1 – Business trigger to "derivatives adviser" and "derivatives dealer", *De minimis*	Several commenters submitted that a notional value-based *de minimis* exception to "derivatives dealer" requirements be provided to alleviate risk concentration and decreased liquidity.	No change. The Instrument creates a uniform approach to regulating conduct in derivatives markets and promotes consistent protections for market participants. However, a *de minimis* exemption from certain requirements imposed on derivatives dealers is contemplated in Proposed NI 93-102. This is intended to strike a balance between addressing liquidity/market access concerns without significantly impacting protections for market participants.

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s. 1 – Business trigger to "derivatives adviser" and "derivatives dealer", Incidental advisory activities	Several commenters suggested express exclusions of professionals whose advisory services are solely incidental to their business or profession.	Change made. Clarifying language has been added to the CP. Appropriately licensed professionals would generally not be considered to be advising on derivatives if their activities are incidental to their *bona fide* professional activities.
	Commenters suggested express exclusion of otherwise-regulated persons including banks, trust companies and insurance companies. Pension plan sponsors and affiliates providing investment-related services to a Canadian regulated pension fund or subsidiary were requested to be expressly excluded.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
s. 1 – Definition of "eligible derivatives party", General	Several commenters supported the concept of an eligible derivatives party ("EDP") to classify sophisticated market participants. One commenter recommended reconsideration of EDP status for advisers that only advise on an incidental basis (and accordingly do not require registration as derivatives advisers). One commenter suggested that managed account clients be subject to the same carve-outs applicable to EDPs.	We thank the commenters for their comments. We have specifically requested comment in the Notice and Request for Comment in relation to Proposed NI 93-102 as to whether and in what circumstances registered advisers (portfolio managers) under NI 31-103 should be considered derivatives advisers. We will consider these responses in determining whether registered advisers (portfolio managers) should remain included within the EDP definition. We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser in respect of a managed account of an EDP will

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		be subject to the reduced set of obligations contemplated by s. 7 of the Instrument unless otherwise agreed by the firm and the EDP.
s. 1 – Definition of "eligible derivatives party", Consistency with other regulatory definitions	Several commenters suggested that the definition of EDP be expanded to include all "permitted clients" under NI 31-103, including mutual fund dealers, exempt market dealers and charities. The commenters noted the compliance burdens on the derivatives industry if the "permitted client" status cannot be leveraged to determine EDP status under the Instrument.	We have amended the definition of EDP to include certain new categories; however, the definition of EDP has not been extended to expressly include mutual fund dealers, exempt market dealers and registered charities. In terms of the compliance burden, we point out that the financial asset test for companies found in the definition of "permitted client" may be higher than the threshold contemplated in this Instrument. For example, the net asset test that applies to a company that qualifies as a specified commercial hedger in this Instrument is $10,000,000. Furthermore, we are permitting a derivatives firm to leverage a pre-existing "permitted client", "accredited counterparty" or "qualified party" representation from its client as set out in s. 45 of the Instrument for pre-existing transactions. If the conditions in that section are satisfied, then those transactions are only subject to s. 8 [*Fair dealing*], s. 20 [*Daily reporting*] and s. 30 [*Derivatives party statements*]. The definition of EDP is built on the knowledge and experience test found in the *Derivatives Act* (Quebec). Unless a person or company qualifies as an EDP

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		under any of the prescribed categories, we are not persuaded that they otherwise have sufficient sophistication, derivatives-related expertise, or financial resources so as to not require the additional protections afforded to non-EDP customers.
	Several commenters suggested harmonization of the definition of EDP with existing definitions, noting liquidity and equivalence concerns. These definitions included "eligible contract participant" used by the U.S. Commodity Futures Trading Commission ("**CFTC**")[1], "qualified party" in Blanket Order 91-507 *Over-the-Counter Trades in Derivatives* ("**BO 91-507**"),[2] "accredited investor" in National Instrument 45-106 *Prospectus Exemptions* ("**NI 45-106**"), and "permitted client" under NI 31-103.	Change made. We have amended the definition of EDP to include certain new categories, including: • (n) non-individual commercial hedger that has net assets of $10,000,000, • (p) non-individual entity whose obligations under derivatives are fully guaranteed by another EDP, other than an individual or commercial hedger, and • (q) non-individual entity that is a commercial hedger and whose obligations under derivatives are fully guaranteed by another EDP, other than an individual. We believe that, with these changes, the definition of EDP is sufficiently harmonized with the definitions cited by the commenter, recognizing that there are differences in the overall regulatory approach that warrant certain distinctions.

1 See s. 1a(18)(a)(v) of the U.S. *Commodity Exchange Act*.

2 In Quebec, "accredited counterparty" under the Quebec *Derivatives Act*.

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s. 1 – Definition of "eligible derivatives party", para (m)	Several commenters requested a lower asset threshold necessary to qualify as an EDP and specifically requested harmonization with the $10 million threshold applicable to an "eligible contract participant" under the U.S. *Commodity Exchange Act*[3] ("**CEA**") and an "accredited counterparty" under the Quebec *Derivatives Act*.[4] One commenter suggested a threshold of $25 million of total assets instead of net assets. Another commenter suggested that individuals with net assets reaching an aggregate realizable value of $25 million should be treated as EDPs that are not individuals.	Change made. See new paragraph (n) of the EDP definition.
s. 1 – Definition of "Eligible Derivatives Party", para (n)	Two commenters suggested that individuals with minimum net assets of $5 million should be treated as EDPs. One of these commenters suggested harmonization with the definition of "accredited counterparty" under the Quebec *Derivatives Act*.[5]	No change. Based on our analysis, the threshold aggregate realizable value before tax but net of any related liabilities of at least $5 million of *financial assets* is appropriate for the determination of eligible derivatives party status for an individual. This is consistent with the current financial threshold for individuals in the definition of "permitted client" in NI 31-103.
s. 1 – Definition of "eligible derivatives party", Knowledge and experience	Several commenters suggested a "bright line" financial resources test eliminating the knowledge and experience requirements, consistent with the approach in NI 31-103 and NI 45-106. Alternatively, the knowledge and experience requirements should apply	No change. Appropriate knowledge and experience is necessary for a derivatives party to transact in derivatives without the additional protections provided to non-EDPs.

[3] The U.S. Commodity Exchange Act sets out a $10 million total assets test in the definition of "eligible contract participant" (calculated as $10 million in total assets, or, if hedging, a minimum net worth exceeding $1 million).

[4] "Accredited counterparty" under the Quebec *Derivatives Act* 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).

[5] 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).

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requirements of paras (m)-(n)	generally with no transaction-specific determination. One commenter submitted that investable assets do not necessary imply financial sophistication, such that tests based on financial assets may not be indicative of better access to information and less need for protection.	This is also consistent with requirements that currently apply in Quebec under the Quebec *Derivatives Act*.
	Several commenters suggested that the Instrument allow representations as to the knowledge and experience requirements to be given in ISDA Master Agreements or protocols amending them.	Change made. Representations are required to be made in writing and can be included as an element of a broader written agreement.
	One commenter noted that to the extent previously given representations are no longer true or reliable about a party's knowledge and experience with particular types of derivatives, the knowledge and experience requirements may potentially trigger default events, followed by transaction terminations, under derivatives trading agreements. As the OTC derivatives market is characterized by inter-related transactions, such default and subsequent termination may spread to other derivatives transactions among different parties.	No change. The CP provides guidance on when a derivatives firm may rely on a representation. See CP guidance on subsection 1(7).
	One commenter submitted that it is practically remote to receive written representations from each counterparty and requested that derivatives firm be allowed to otherwise confirm, acting reasonably, that the counterparty satisfies the requirements.	No change. Representations form part of the written agreements that document derivatives transactions.
s. 1 – Definition of "eligible derivatives party", Waiver and representations	Several commenters suggested that market participants who would not otherwise qualify for EDP status be allowed to affirmatively represent their qualification to evaluate risks associated with derivatives transactions and waive the applicability of certain provisions.	No change. However, new paragraphs have been added under the definition of eligible derivatives party. A person or company, other than an individual, may qualify for EDP status under these new paragraphs.

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See also s. 7 below.	One commenter submitted that allowing an investor to waive protections may result in abuse.	No change. Derivatives firms have an obligation to act in good faith. Applying undue pressure on a derivatives party to waive protections would be a breach of that obligation.
	Several commenters requested clarification that there is no affirmative duty to perform an investigation of a party's representation or warranty, unless a reasonable person would have grounds to believe that such statements are false or otherwise unreasonable to rely on.	Change made. We have further clarified that a derivatives firm may rely on written representations unless it would be unreasonable to do so. See CP guidance on subsection 1(7).
s. 1 – Definition of "eligible derivatives party", Commercial hedger	Several commenters requested that the definition of EDP include an exemption for hedgers. The commenters suggested a definition similar to the existing exemptions in BO 91-507 for "qualified parties" or "eligible contract participants" in the U.S., and broad enough to include all end-users who currently transact in OTC derivatives transactions for hedging purposes. One commenter submitted that regardless of size, many commercial operations need to hedge their foreign currency or interest rate risks and no market other than the OTC derivatives market can provide an equivalent tailored risk management solution.	Change made. Please see new paragraphs (n) and (q) under the definition of EDP. A person or company, other than an individual, will qualify for EDP status subject to certain requirements when it meets the definition of commercial hedger.
s. 1 – Definition of "eligible derivatives party", Guarantees	Several commenters suggested that the definition of EDP also include an entity whose obligations are guaranteed by an entity that otherwise qualifies as an EDP. One of these commenters suggested that the definition of EDP also include an entity that wholly, directly or indirectly, owns, is owned by, or is under common ownership with, one or more EDPs.	Change made. Please see new paragraph (p) under the definition of EDP. A person or company, other than an individual, whose obligations under a derivative are fully guaranteed or fully supported (under a letter of credit or credit support agreement) by one or more eligible derivatives parties will qualify for EDP status subject to certain conditions.

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Part 2 – Application		
s. 3 – Application - scope of instrument	One commenter submitted that the imposition of the same requirements on derivatives advisers as those on derivatives dealers creates a duplicative and unnecessary compliance burden.	Change made. The CP has been revised to include additional guidance on the business trigger for advising. The requirements in the Instrument are generally similar to existing business conduct requirements applicable to registered advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets. Accordingly, we do not believe that the proposed regulatory regime for derivatives advisers unnecessarily duplicates the regime for derivatives dealers.
	One commenter suggested that members of the Investment Industry Regulatory Organization of Canada ("**IIROC**") not be required to comply with the Instrument.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
	One commenter suggested exempting derivatives firms that adhere to the FX Global Code of Conduct, whether or not their counterparty is an EDP. Alternatively, that such exemption applies in respect of physically-settled FX swaps and FX forwards.	No change. The FX Global Code of Conduct does not impose legal or regulatory obligations on market participants. Many of the requirements in the Instrument are principles-based and may be satisfied in different ways. We encourage derivatives firms that trade or advise others in relation to FX-related derivatives to consider the contents of the FX Global Code of Conduct in

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		developing their policies and procedures aimed at complying with the requirements of the Instrument.
s. 4 – Application – affiliated entities	One commenter supported the inclusion of s. 4, which exempts a person providing derivatives advisory services to an affiliated entity from the Instrument. The commenter requested an exemption for the person providing investment advisory services for no compensation to an associated or related person that does not otherwise fall within the definition of an affiliated entity. Alternatively, that guidance clarify that such person does not trip any business trigger as a "derivatives adviser".	We thank the commenter for their comment. A person or company that deals with or advises an entity that meets the definition of "affiliated entity" may qualify for the exemption. However, the exemption is not available if the affiliated entity is an investment fund. We have specifically requested comment in the Notice and Second Request for Comment in relation to this Instrument and in the Notice and Request for Comment in relation to Proposed NI 93-102 as to how we should define the concept of affiliated entity for the purposes of these rules.
s. 5 – Application - qualifying clearing agencies	One commenter requested clarification on whether derivatives firms are exempt from the Instrument when facing regulated clearing agencies. The commenter also requested that EDP status be granted for clearing agencies that enter into proprietary trades that are not cleared transactions.	Change made. Qualifying clearing agencies have been added to the definition of EDP. See new paragraph (r) under the definition of EDP. A clearing agency will be an EDP for all trades, including proprietary trades.
s. 6 – Application - governments, central banks and international organizations	Two commenters requested clarification on whether derivatives firms are exempt from the Instrument when facing entities listed under s. 6.	Clarifying language has been added to the CP to make it clear that derivatives firms are not exempt from their obligations when facing government entities, central banks and international organizations. However, these entities will generally be EDPs.

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	One commenter suggested expanding the list of excluded entities to include (1) crown corporations, government agencies and any other entity wholly owned or controlled by, or all of whose liabilities are guaranteed by, one or more governments, central banks and international organizations, and (2) state, regional and local governments in foreign jurisdictions.	No change. To ensure a level playing field, all derivatives dealers and derivatives advisors are subject to a minimum set of standards in their dealings with derivatives parties.
s. 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party, General	Several commenters supported the two-tiered approach of the Instrument with the effect that a substantial portion of the Instrument will not apply to transactions with an EDP and submitted that no additional requirements are necessary when a derivatives firm deals with an EDP. Two commenters suggested a three-tier approach with the effect of an outright exemption for the inter-dealer market.	No change. The Instrument sets out a two-tiered regime with the effect that a derivatives firm is not required to comply with certain requirements in the Instrument when dealing with eligible derivatives parties. The obligations of a derivatives firm differ depending on the nature of the derivatives party. Please see s. 7 of the Instrument and related guidance in the CP. The inter-dealer market will typically involve transactions between two EDPs and since those parties can bargain for appropriate protections, they are subject to a limited set of provisions in this Instrument. It is inappropriate and inconsistent with the rule to provide an outright exemption for the inter-dealer market and also inconsistent with the approach taken internationally.
s. 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives	Three commenters submitted that the Instrument requires individual EDPs to waive in writing the second tier of requirements. The commenters suggested that individual EDPs be exempt from the second-tier requirements similar to other categories of EDPs. In the alternative, the commenters requested that no new waiver be required from the individual every 365 days and instead the onus for revocation be placed on the individual.	Change made. An individual eligible derivatives party may waive, in writing, any or all of the requirements of the Instrument, other than as set out in s. 7(1). Waiver may be included in account-opening documentation or other relationship disclosure, and there is no obligation to update the waiver once a derivatives party has begun

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party, subsection (2)		trading. A derivatives party may withdraw their waiver at any time.
s. 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party, subsection (3)	Several commenters suggested that s. 7(3) be deleted on the basis that disclosures and protections are not affected by whether the trading decision is client-directed or at the discretion of the adviser. Managed account clients benefit from both the fiduciary obligation owed to them by their adviser and the contractual terms of the investment management agreement. In the alternative, the commenters requested that managed account clients be permitted to waive sections of the Instrument that but for s. 7(3) would not apply.	Change made. The requirements of the Instrument are not dependent on whether a derivatives firm is acting as an adviser to an EDP or an adviser in respect of a managed account of an eligible derivatives party. We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser in respect of a managed account of an EDP will be subject to the reduced set of obligations contemplated by s. 7 of the Instrument unless otherwise agreed by the firm and the EDP.
Part 3 – Dealing with or Advising Derivatives Parties		
Division 1 – General Obligations Towards All Derivatives Parties		
s. 8 – Fair dealing	Several commenters supported the fair dealing requirements, noting the importance of regulatory tools necessary to enforce against deceptive and manipulative trading practices or fraudulent activity. One commenter requested clarification on s. 8 as compared with s. 19.	We thank the commenters for their comments. Change made. Former stand-alone provision in s. 19 on fair terms and pricing has been removed and clarifying language in the CP has been added that fair terms and pricing may, in certain circumstances, be viewed to fall within the overall fair dealing principle in s. 8.
	Two commenters suggested higher requirements for derivatives advisers, while other commenters noted that fiduciary standards apply, NI 31-103 regulates derivatives advisers, and that	We have deleted proposed subsection 7(3) of the version of the Instrument published for comment in April 2017. Accordingly, a derivatives firm acting as an adviser/investment

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	transactions are often of a bespoke nature.	counsel to an EDP will be subject to the same set of obligations under the Instrument as a derivatives firm acting as an adviser/portfolio manager for an EDP. However, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law.
	One commenter requested an exemption for derivatives firms dealing with other derivatives firms or financial institutions.	No change. However, clarifying language has been added to the CP. Fair dealing obligations will be interpreted flexibly and in a manner sensitive to context.
	One commenter submitted that the need for regulation has not been identified, as no appreciable or material examples of banks or other derivatives firms have been identified in Canada as violating existing fair dealing rules.	No change. Canadian jurisdictions are committed to implementing harmonized business conduct rules that will protect derivatives parties in the Canadian market.
	One commenter submitted that fair dealing should not change depending on the sophistication of counterparties and s. 8 should be deleted. The commenter submitted that the derivatives dealer relationship is not a fiduciary one, nor does good faith generally apply to the negotiation of transactions at common law. In the alternative, s. 8 should be harmonized with other regulatory regimes, which do not impose requirements on individuals acting on behalf of a derivatives firm.	No change. Fair dealing obligations will be interpreted flexibly and in a manner sensitive to context.
s. 9 – Conflicts of interest	Two commenters requested clarification of the Instrument and CP, particularly with respect to the divergent nature of two parties' interests. For conflicts of interest not prohibited by law, the only	No change. Requirements relating to conflicts of interest are a central pillar of business conduct regulation.

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	regulatory requirement should be to identify and disclose material conflicts. One of the commenters suggested limiting the requirement to conflicts of interest relating to research and clearing activities.	
	One commenter suggested eliminating specific conflict of interest requirements with respect to derivatives advisers, as they face fiduciary obligations.	The requirements in the Instrument are generally similar to existing business conduct requirements applicable to registered advisers under NI 31-103 but have been tailored to reflect the different nature of derivatives markets. These requirements include requirements in relation to identifying and responding to conflicts of interest. We acknowledge that, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law. However, this may not be the case where the derivatives adviser is merely providing advice in relation to derivatives or strategies but does not exercise discretion over the EDP's account.
	One commenter submitted that the Instrument overlaps with conflicts of interest requirements under existing Canadian laws[6] and that overlapping requirements should be removed from the Instrument.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and

[6] The *Bank Act* requires Canadian banks to establish procedures to identify and address conflicts of interest. 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.

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		foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
	Two commenters submitted that disclosure must be specific and provided before a transaction takes place, recognizing that in certain situations disclosure may be more appropriate after the transaction. Another commenter requested that the use of standardized disclosures be permitted, provided that additional or particularized disclosures are made available as appropriate.	Change made. Please see revised CP guidance related to s. 9. We expect derivatives firms to provide general and specific disclosures.
s. 10 – Know your derivatives party, General	Several commenters suggested harmonization of s. 10 with similar regulatory requirements in other jurisdictions.[7] Several commenters submitted that an exemption is needed for derivatives dealers that do not know the identity of their counterparties prior to execution of the transaction.	Change made. New s. 41 exempts a derivatives firm in certain circumstances where it does not know the identity of its derivatives party prior to the execution of the transaction. The exemption in s. 41 is applicable to transactions executed on a derivatives trading facility (or analogous platform) where at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the availability of a similar exemption in respect of derivatives traded anonymously on a derivatives trading facility that are not cleared, derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency, and otherwise if it is appropriate to extend the scope of the exemption

[7] See CFTC's relief in No Action Letter 13-70 in respect of swaps that are intended to be cleared.

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		to other sections of this Instrument. We understand that a trading platform would perform know-your-derivatives-party diligence prior to accepting a derivatives party for trading on the platform. We consider this to be a reasonable steps obligation and we would accept that if it is not possible to know the identity of the counterparty, that information is not required.
s. 10 – Know your derivatives party, subsection (2)	Several commenters requested that s. 10(2)(c) be removed, submitting that it is disproportionately impracticable to 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 relating to any interest underlying the derivative.	No change. These obligations already exist for registered firms under securities legislation. In the case of derivatives firms that are not currently registered under securities legislation but nevertheless provide products or services in relation to equity derivatives, we would expect these firms today to have policies and procedures in place aimed at preventing illegal insider trading and tipping. This information is necessary to ensure that securities law is being complied with.
s. 10 – Know your derivatives party, subsection (4)	Two commenters requested that information be deemed current, unless a client informs a derivatives firm otherwise.	No change. The requirements in relation to “gatekeeper” KYDP in s. 10 of the Instrument and “derivatives-party-specific” KYDP in s. 11 of the Instrument are generally consistent with existing “know-your-client” obligations under Canadian securities legislation and comparable requirements in foreign jurisdictions. This information is necessary to ensure that securities law is being complied with.

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s. 10 – Know your derivatives party, subsection (5)	Two commenters requested an expansion of s. 10(5) to cover EDPs, registration-exempt entities, and foreign financial institutions.	No change. Know-your-derivatives party requirements do not apply to a registered securities firm, registered derivatives firm, or a Canadian financial institution.
Division 2 – Additional Obligations when Dealing with or Advising Certain Derivatives Parties		
s. 12 – Suitability	Two commenters requested clarification on what constitutes a recommendation by a derivatives dealer. The commenters suggested that suitability be limited to recommendations, and not instructions.	No change. Reasonable steps must be taken 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.
	One commenter requested that s. 12 clarify 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.	No change. Reasonable steps must be taken 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. If a discrete transaction fits into a larger trading strategy or series of transactions, and the derivatives firm has determined that the larger trading strategy or series of transactions is suitable for the derivatives party, it is unclear why there should be a concern over the discrete transaction.
	One commenter submitted that specific suitability obligations are not necessary in the case of a derivatives adviser, as they have broader fiduciary obligations.	We acknowledge that, where a derivatives firm is acting as an adviser to a fully managed account for a derivatives party, including an EDP, the derivatives firm may be subject to a fiduciary duty under certain statutes and under common law. However, this may not be the case where the derivatives adviser is merely providing advice in relation to

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		derivatives or strategies but does not exercise discretion over the EDP's account.
	Two commenters requested safe harbours from the suitability requirements, including for derivatives dealers and intended to be cleared derivatives.	No change. Suitability requirements are crucial to the protection of non-EDPs. Suitability requirements do not apply when trading with or advising non-individual EDPs and apply, but may be waived, when trading with or advising individual EDPs. As explained in the Notice and Request for Comment for the Instrument published in April 2017, this is generally similar to the regime that applies to registered securities firms under NI 31-103.
s. 13 – Permitted referral arrangements	Three commenters submitted that s. 13 imposes broad obligations. One commenter requested clarification that establishing a relationship with a dealer on behalf of an advisory client does not constitute a referral arrangement. Other commenters requested that s. 13 be removed to better align with the absence of comparable obligations in CFTC rules. Alternatively, that s. 13 apply only to referral arrangements that specifically involve derivatives and that exemptions be provided for inter-group referrals.	No change. The requirements in relation to permitted referral arrangements do not apply if the firm is trading with or advising non-individual EDPs and apply but may be waived if the firm is trading with or advising individual EDPs. In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms.
Former s. 16 – Disclosure regarding the use of borrowed money or leverage	One commenter requested that to avoid duplication, the disclosure statement apply only to derivatives dealers. The commenter requested clarification that posting of the disclosure statement on a website in a readily accessible location will be sufficient.	Change made. Disclosure regarding the use of borrowed money or leverage has been incorporated into new s. 19. Disclosure must be delivered to a derivatives party.

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Former s. 17 – Handling complaints	One commenter suggested harmonization with CFTC rules by eliminating complaint handling obligations.	No change. The requirements in relation to complaint handling do not apply if the firm is trading with or advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs. In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms. Please see the Instrument and related guidance in the CP.
Division 3 – Restrictions on Certain Business Practices when Dealing with Certain Derivatives Parties		
Former s. 18 – Tied selling	One commenter suggested that tied selling obligations are duplicative of existing Canadian legislation and should be eliminated to better align with other regulatory regimes.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 19 – Fair terms and pricing	Two commenters supported the requirement. One commenter submitted that the terms are better suited to CP guidance on s. 8. Another submitted that the inclusion of an express best execution requirement would be beneficial to avoiding conflicts. Two other commenters suggested that the requirement should be deleted. The commenters suggested that given the negotiated, bilateral and bespoke nature	Change made. Former s. 19 on fair terms and pricing has been merged with s. 8. Clarifying language has been added to the CP in relation to guidance on s. 8. Both the compensation and market value or price components of a derivative are relevant to a derivatives firm’s obligation to transact with derivatives parties under terms and pricing that are fair. Derivatives firms are

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	of transactions, there is no fair price beyond what the parties agree, and that legal obligations and remedies already exist.	expected to set and follow policies and procedures that are reasonably designed to achieve the most advantageous terms for the derivatives firm's derivatives parties.
Part 4 – Derivatives Party Accounts		
Division 1 – Disclosure to Derivatives Parties		
Division 1, General	Several commenters suggested harmonization of the requirements with CFTC rules. Derivatives firms should not be required to provide valuations or related inputs and assumptions and that instead "mid-market marks"[8] should be used. Several other commenters supported the requirement to provide valuations that are accompanied by inputs and assumptions in order to make the estimates/prices more meaningful. Commenters suggested that daily marks should only be required for uncleared transactions. One commenter suggested limiting "inputs and assumptions" to "methodology and assumptions".	Change made. Please see revised CP guidance on the definition of valuation.
Former s. 20 – Relationship disclosure information	One commenter submitted that certain relationship documentation listed in former s. 20(2) is not applicable for a derivatives relationship.	No change made. The requirements in relation to client relationship disclosure do not apply if the firm is trading with or advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs. In the case of firms trading with or advising non-EDPs, these requirements are generally consistent with requirements in NI 31-103 applicable to IIROC CfD/forex firms.

[8] CFTC rules do not include amounts for profit, credit reserve, hedging, funding, liquidity or other costs or adjustments in the mid-market mark.

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		The required disclosure is important for non-EDPs to understand the risks associated with derivatives.
Former s. 21 – Pre-transaction disclosure	One commenter requested that the use of standardized disclosures be permitted provided additional or particularized disclosures are made available as appropriate.	No change. Where standardized disclosure meets all requirements, it is acceptable.
	Two commenters requested clarification that pre-transaction disclosures do not apply where the transaction is an intended to be cleared derivative or executed on an exchange.	No change. Pre-transaction disclosures are required for all transactions with non-EDPs.
	One commenter requested clarification on when disclosure would not be required as result of the application of subsection (2)(b) and what additional information is intended by subsection (2)(c).	Change made. The phrase "if applicable" has been removed from new s. 19(2)(b). Compensation not reflected in the price would be required to be disclosed pursuant to s. 19(2)(c).
Former s. 22 – Daily reporting	Only derivatives dealers should have a daily reporting obligation, and it is sufficient for derivatives advisers to provide reporting on a monthly basis, unless otherwise agreed.	Change made. See new s. 20(2).
Former s. 23 – Notice to derivatives parties by non-resident derivative firms	One commenter submitted that the notice requirement for non-resident derivatives firms is duplicative of former s. 20 and standard information that is provided in relationship documentation.	No change. However, clarifying language has been added to the CP. A separate statement is not required when information required is already provided to counterparties under standard form industry documentation.
Division 2 – Derivatives Party Assets		
Division 2, General	Several commenters requested a revision of Division 2 of Part 4 to recognize that re-hypothecation is a private commercial matter, unless otherwise subject to existing regulatory restrictions, such as segregation, margin, and specific types of counterparty requirements.	Change made. A derivatives firm is exempted from the requirements of the division if it is subject to and complies with or is otherwise exempt from National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* ("**NI 94-**

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	Two commenters submitted that only former s. 24 should apply to EDPs. Two commenters requested clarification of the application of the requirements to derivatives advisers fulfilling discretionary mandates, for which they are generally given authority by their clients with respect to the use and investment of assets.	**102**"), securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds*. We note that ss. 25 and 26 only apply to transactions with non-EDPs. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the appropriate model for protecting customer assets of derivatives parties.
Former s. 24 – Interaction with NI 94-102	Several commenters submitted that the Instrument was more onerous than securities instruments such as NI 94-102. One commenter requested clarification regarding the application of provisions relating to the segregation, use, holding and investment of derivatives party assets as applied to a portfolio manager acting on behalf of a managed account client, where the adviser has been granted authority with respect to portfolio assets that include but are not limited to derivatives. Another commenter requested clarification of the exemption from Division 2 for parties relying on the substituted compliance provisions in NI 94-102.	Change made. In circumstances where initial margin has been delivered by a non-EDP to a derivatives firm, the requirement is that this collateral will be (i) segregated and held at a permitted depository and (ii) the derivatives firm has obtained written consent from its counterparty to the use or investment of the collateral. Division 2 does not apply to a derivatives firm for transactions that are subject to NI 94-102, including firms relying on exemptions in that instrument.
Division 3 – Reporting to Derivatives Parties		
Former s. 29 – Content and delivery of transaction information	Two commenters supported the requirement that transactions be confirmed in writing but submitted the prescriptive contents of those confirmations are not appropriate. The commenters requested harmonization with CFTC requirements.	No change. However, clarifying language has been added to the CP. New s. 41 exempts a derivatives firm from the requirement in subsection 27(1) to deliver a written confirmation of the

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	The commenters requested clarification of the application of the requirement to uncleared derivatives and that electronic confirmations satisfy the "in writing" requirement.	transaction in certain circumstances. The exemption in s. 41 is applicable to transactions executed on a derivatives trading facility (or analogous platform) where at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party. We have specifically requested further comment in the Notice and Second Request for Comment in relation to this Instrument about the availability of a similar exemption in respect of derivatives traded anonymously on a derivatives trading facility that are not cleared, derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency, and otherwise if it is appropriate to extend the scope of the exemption to other sections of this Instrument. The requirements in relation to client relationship disclosure do not apply if the firm is trading with or advising non-individual EDPs and apply, but may be waived, if the firm is trading with or advising individual or specified commercial hedger EDPs.
Former s. 30 – Derivatives party statements	One commenter noted that there are no requirements to prepare monthly statements under either the CFTC rules or MiFID II.[9] As it would require derivatives dealers to implement new reporting technology, the commenter	No change. Monthly statements contain important information for non-EDPs to monitor their derivatives transactions. The requirements in relation to client relationship disclosure do

[9] 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**").

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	requested that the requirement to deliver monthly statements be removed.	not apply if the firm is trading with or advising non-individual EDPs and apply but may be waived if the firm is trading with or advising individual or specified commercial hedger EDPs.
Part 5 – Compliance and Recordkeeping		
Division 1 – Compliance		
Former s. 33 – Responsibilities of senior derivatives managers	Several commenters requested that former s. 33 be eliminated or the responsibilities reassigned to a chief compliance officer to reflect current industry best practices. A derivatives manager's oversight of activities within the derivatives manager's functional business unit is a conflict of interest. Any reporting to the regulators should be the obligation of the chief compliance officer. One commenter, noting the Office of the Superintendent of Financial Institutions ("**OSFI**") Guidelines,[10] submitted that the proposed requirements are at odds with the existing compliance structure. Two commenters submitted that the context where a specific duty has been introduced for senior managers in other jurisdictions is distinguishable from that in Canada. There has not been any crisis of confidence in Canada. Where specific duty has been imposed, it has been part of a comprehensive framework across business lines and the responsibility is shared across multiple functions. Several commenters noted that personal liability for a senior derivatives manager is unwarranted and inconsistent with best practices.	Change made. Revisions have been made to the Instrument and CP to better reflect existing compliance structures at derivatives firms.

[10] For example, OSFI Guideline E-13 *Regulatory Compliance Management* and OSFI Guideline E-21 *Operational Risk Management.*

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	One commenter requested clarification of CP guidance on "serious misconduct" and "material non-compliance".	No change. The CP provides guidance on these terms. See CP guidance under new s. 31 – responsibilities of senior derivatives managers
	One commenter requested 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 chief compliance officer. A separate senior derivatives manager regime should not be mandated for firms registered as portfolio managers under NI 31-103.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
	One commenter submitted that there should be flexibility to former s. 33(2) to submit reports to senior management in lieu of reporting to the board. Another commenter submitted that all instances of material non-compliance should be reported no less frequently than on an annual basis and following the review of the annual report by the board.	Change made. The instrument has been revised in new s. 31 to permit a senior derivative manager to delegate its responsibility for submitting the report to the board to the firm's chief compliance officer.
Former s. 34 – Responsibility of derivatives firm to respond to material non-compliance	One commenter submitted that former s. 34(b) places a broad and onerous self-reporting burden on derivatives firms without precedent in Canadian securities legislation and should be removed from the Instrument. One commenter requested clarification of the CP guidance related to former s. 34 to expressly provide an opportunity for derivatives firms to raise issues with their board before being required to report to regulators.	No change. Self-reporting is a key element of the Instrument. The Instrument does not prohibit issues of material non-compliance with the Instrument from being raised with a board as long as the report is submitted to the regulator in a timely manner.

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Division 2 – Recordkeeping		
Division 2 – General	One commenter submitted that recordkeeping obligations already exist under OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* and OSFI Guidelines for federally regulated financial institutions. One commenter submitted that federally regulated financial institutions should be exempt from compliance and in the alternative, should be granted substituted compliance.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 35 – Derivatives party agreement	Two commenters requested an exemption for transactions that are executed on an exchange and for transactions that are cleared.	No change. However, clarifying language has been added to the CP.
	Two commenters submitted that firms regularly enter into foreign exchange transactions prior to completing an ISDA Master Agreement and should be exempt from such requirement.	No change. A written agreement should be entered into prior to completing a transaction.
Former s. 36 – Records	Several commenters note that the recordkeeping requirements are too broad and the added costs on derivatives firms will be passed on to other market participants. Commenters suggested that the recordkeeping obligations be limited to keeping records of communications related to the negotiation, execution and amendment or termination of derivatives. All records of communications should not be kept where a record of those communications otherwise exists.	No change. Please see the Instrument and related guidance in the CP.
Former s. 37 – Form, accessibility and retention of records	Two commenters submitted that the length of the record retention requirement exceeds that of the CFTC.	No change. This retention period is consistent with other Canadian requirements.

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Part 6 – Exemptions		
Division 1 – Exemption from this Instrument		
Former s. 39 – Exemption for certain derivatives end-users, General	Two commenters requested clarification of the scope of the end-user exemption and suggested reference to particular categories of persons. Several commenters submitted that the availability of the end-user exemption should not be restricted to parties that interact solely with EDPs.	Change made. The end-user exemption in new s. 37 of the Instrument has been amended to clarify the scope of the exemption. The end-user exemption includes the following conditions: • (a) the person or company does not solicit or otherwise transact a derivative with, for or on behalf of, a non-eligible derivatives party; • (b) the person or company does not, in respect of any derivative or transaction, advise non-eligible derivatives parties, other than general advice that is provided in accordance with the conditions of s. 42 [*Advising generally*]; • (c) the person or company does not regularly 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 for another person or company other than an

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		affiliated entity that is not an investment fund; • (e) the person or company does not facilitate clearing of a derivative through the facilities of a qualifying clearing agency for another person or company. Although the end-user exemption includes a condition that the person or company does not solicit or transact with a non-EDP, we have also amended the definition of EDP to include a specified commercial hedger category. We believe this should partially address the commenter's concerns.
Former s. 39 – Exemption for certain derivatives end-users, para (c)	Several commenters submitted that entities that are market-makers and that do not otherwise act as derivatives dealers or advisers, but regularly quote prices due to a need to regularly hedge positions, should not be excluded from the end-user exemption. One commenter requested clarification on whether former s. 39(c) is intended to capture commodity firms trading amongst themselves in the over the counter market.	No change. However, clarifying changes have been made to the CP. A person or company that frequently and regularly transacts in derivatives to hedge business risk but that does not undertake any of the activities listed in new s. 37 may qualify for this exemption.
Division 2 – Exemptions from Specific Requirements in this Instrument		
Former s. 40 – Foreign derivatives dealers, General	One commenter submitted that substituted compliance from substantially the entire Instrument should be granted either to both foreign derivatives dealers and Canadian financial institutions or to neither of them in order to maintain a level playing field.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed

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		equivalent will be published for comment prior to the finalization of this Instrument.
	One commenter requested that corresponding domestic and foreign laws that can be complied with in lieu of the Instrument and the residual provisions of the Instrument be published for consultation before the Instrument is finalized.	Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 40 – Foreign derivatives dealers, subsection (1)	One commenter submitted that the foreign dealer exemption should not be conditional on dealings with EDPs when the business conduct rules of a foreign jurisdiction are deemed equivalent.	No change. The foreign dealer exemption is not available to derivatives firms that transact with non-EDPs. This approach is similar to the approach taken towards foreign dealers in NI 31-103.
Former s. 40 – Foreign derivatives dealers, subsection (3)	Two commenters submitted that the requirement to deliver a statement pursuant to former s. 40(3)(c) in order to qualify for the exemption does not provide any additional protection and the disclosures are generally addressed in the Master Agreement. This type of statement is not required by the CFTC as a condition of substituted compliance. This requirement should be removed, and disclosure in a Master Agreement should be sufficient. In the alternative, the statement should only be required delivered to non-EDPs.	No change. However, clarifying language has been added to the CP. Disclosures contemplated in s. 38(3)(b) can be made by a derivatives firm in a master trading agreement with its counterparty.
	Several commenters requested clarification on the policy rationale behind former s. 40(3)(e) on which the exemption for foreign dealers based on substituted compliance is not available if the dealer is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction, particularly if only dealing with EDPs.	Change made. The subsection was removed. A person or company in the business of trading in derivatives on an exchange or a derivatives trading facility is no longer prohibited from qualifying for the exemption under new s. 38(1).

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Division 3 – Exemptions for Derivatives Advisers		
Division 3, General	One commenter submitted that a corresponding exemption to former s. 41 should be added for portfolio managers, as they have limited derivatives activity.	We have specifically requested comment in the Notice and Request for Comment in relation to Proposed NI 93-102 as to whether and in what circumstances registered advisers (portfolio managers) under NI 31-103 should be considered derivatives advisers. We will consider these responses in determining whether registered advisers (portfolio managers) that provide incidental advice in relation to derivatives should be considered in the business of advising in relation to derivatives or whether an express exemption is required.
Former s. 44 – Foreign derivatives advisers, General	Several commenters generally supported exempting foreign derivatives advisers but noted that the exemption is too narrow, as many jurisdictions do not subject derivatives advisers to registration. Derivatives advisers should be exempt from the Instrument when exempt or not required to be registered in their principal jurisdiction, which would better align with the international adviser exemption in NI 31-103.	No change. We have intentionally limited the exemption in s. 43 [*Foreign derivatives advisers*] of the Instrument to foreign derivatives advisers that are "registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix D".
	One commenter requested that corresponding domestic and foreign laws that can be complied with in lieu of the Instrument and the residual provisions of the Instrument be published for consultation before the Instrument is finalized.	Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.
Former s. 44 – Foreign derivatives advisers, subsection (1)	One commenter submitted that the foreign adviser exemption should not be conditional on dealings with EDPs when the business conduct rules of a foreign jurisdiction are deemed equivalent.	No change. The foreign adviser exemption is not available to derivatives firms that transact with non-EDPs.

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Former s. 44 – Foreign derivatives advisers, subsection (3)	One commenter submitted that the requirement to deliver a statement pursuant to former s. 44(3)(c) in order to qualify for the exemption does not provide any additional protection and is inconsistent with former s. 23, which requires a similar statement only be delivered to non-EDPs.	No change. However, clarifying language has been added to the CP. Disclosures contemplated in s. 43(3)(b) can be made by a derivatives firm in a master trading agreement with its counterparty.
	Several commenters requested clarification on the policy rationale behind former s. 44(3)(e) on which the exemption for foreign advisers based on substituted compliance is not available if 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, particularly if only dealing with EDPs.	Change made. A person or company in the business of trading in derivatives on an exchange or a derivatives trading facility is no longer prohibited from qualifying for the exemption under s. 43(1).
Part 7 – Granting an Exemption		
Former s. 45 – Exemption	One commenter submitted that credit unions make available products largely on demand to provide a full suite of services and do not operate platforms, are not market makers, and are not directly offering quotes. Credit unions are the intended beneficiaries of the Instrument and qualify for the end-user exemption. Credit unions should not be defined as derivatives dealers or advisers and should fall outside the scope of the Instrument.	No change. The exemption available for derivatives end-users that satisfy certain requirements is set out in s. 37. Discretionary exemptions are available on an ad-hoc basis.
	One commenter submitted that IIROC-regulated dealers are already regulated and should be exempt from the Instrument.	No change. This Instrument will include exemptions for entities that are subject to and comply with other regulatory requirements that, on an outcomes basis, are equivalent to requirements in this Instrument. Requirements of Canadian and foreign regulators that are deemed equivalent will be published for comment prior to the finalization of this Instrument.

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Part 8 – Effective Date		
Former s. 46 – Effective date	Two commenters suggested delaying the implementation date to harmonize the Instrument with CFTC and Securities and Exchange Commission rules.	No change. Canadian jurisdictions are committed to implementing harmonized business conduct rules.
	Several commenters suggested extending the implementation period to become compliant to 6 months for previously regulated firms and 12 months for those not previously regulated.	No change. Please see the Instrument and related guidance in the CP.
	One commenter submitted that all pre-effective date transactions regardless of their remaining term should be grandfathered and that grandfathering should apply even if pre-effective date transactions are subsequently amended after the date the Instrument is finalized.	We are permitting a derivatives firm to leverage a pre-existing "permitted client", "accredited counterparty" or "qualified party" representation from its client as set out in s. 45 of the Instrument for pre-existing transactions. If the conditions in that section are satisfied, then those transactions are only subject to s. 8 [*Fair dealing*], s. 20 [*Daily reporting*] and s. 28 [*Derivatives party statements*].

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List of Commenters

1. Associated Foreign Exchange, ULC
2. Bruce Power L.P.
3. Canadian Bankers Association
4. Canadian Credit Union Association
5. Capital Power Corporation
6. Enbridge Inc.
7. Franklin Templeton Investments Corp.
8. International Energy Credit Association
9. International Swaps and Derivatives Association, Inc.
10. Investment Industry Association of Canada
11. Investor Advisory Panel
12. Just Energy Corp.
13. NorthPoint Energy Solutions, Inc.
14. Osler, Hoskin & Harcourt LLP
15. Pension Investment Association of Canada
16. Portfolio Management Association of Canada
17. SIFMA Asset Management Group
18. The Canadian Advocacy Council for Canadian CFA Institute Societies
19. The Canadian Commercial Energy Working Group
20. The Canadian Market Infrastructure Committee
21. Western Union Business Solutions

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ANNEX II

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 any of the following:

(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;

(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;

"collateral" means all cash, securities and other property that is

(a) received or held by the derivatives firm from, for or on behalf of a derivatives party, and

(b) intended to or does margin, guarantee, secure, settle or adjust one or more derivatives between the derivatives firm and the derivatives party;

"commercial hedger" means a person or company that carries on a business and that transacts a derivative that is intended to hedge risks relating to that business if those risks arise from potential changes in value of any of the following:

(a) an asset that the person or company owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;

(b) a liability that the person or company incurs or anticipates incurring;

(c) a service which the person or company provides, purchases, or anticipates providing or purchasing;

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"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 in respect of derivatives, and

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

"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 securities legislation;

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

"derivatives party" means

(a) in relation to a derivatives dealer, any of the following:

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

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

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

"derivatives party assets" means any asset, including collateral, received or held by a derivatives firm from, for or on behalf of a derivatives party;

"derivatives position" means the economic interest of a counterparty in an outstanding derivative at a point in time;

"eligible derivatives party" means, for a derivatives party of a derivatives firm, 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);

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(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 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 the pension fund;

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

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

(h) the government of a 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) 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 account managed by the trust company or trust corporation, as the case may be;

(k) a person or company that is acting on behalf of a managed account if the person or company is registered or authorized to carry on business as one of the following:

(i) an adviser or a derivatives adviser;

(ii) the equivalent of an adviser or a derivatives adviser under the securities legislation of a jurisdiction of Canada or of a foreign jurisdiction;

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

(m) a person or company, other than an individual, that has represented to the derivatives firm in writing, that

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

(ii) it has net assets of at least $25 000 000 as shown on its most recently prepared financial statements;

(n) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that

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

(ii) it has net assets of at least $10 000 000 as shown on its most recently prepared financial statements, and

(iii) it is a commercial hedger in relation to the derivatives that it transacts with the derivatives firm;

(o) an individual that has represented to the derivatives firm, in writing, that

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

(ii) he or she 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 $5 000 000;

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(p) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that its obligations under derivatives that it transacts with the derivatives firm are fully guaranteed or otherwise fully supported, under a written agreement, by one or more eligible derivatives parties, other than a person or company that only qualifies as an eligible derivatives party under paragraph (n) or under paragraph (o);

(q) a person or company, other than an individual, that has represented to the derivatives firm, in writing, that all of the following apply:

(i) the person or company is a commercial hedger in relation to the derivatives that it transacts with the derivatives firm;

(ii) the obligations of the person or company, under derivatives that it transacts with the derivatives firm, are fully guaranteed or otherwise fully supported, under a written agreement, by one or more eligible derivatives parties that qualifies as an eligible derivatives party under paragraph (n);

(r) a qualifying clearing agency;

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

"IIROC" means the Investment Industry Regulatory Organization 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 transact derivatives 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 qualifying clearing agency;

(c) the Bank of Canada or the central bank 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

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(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 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;

"qualifying clearing agency" means a person or company if any of the following applies:

(a) it is recognized or exempted from recognition as a clearing agency or a clearing house, as applicable, in a jurisdiction of Canada;

(b) it is regulated by an authority in a foreign jurisdiction that applies regulatory requirements that are consistent with the *Principles for market infrastructures* applicable to central counterparties, as amended from time to time, and published by the Bank for International Settlements' Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions;

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

"referral fee" means any compensation, regardless of its form, whether made directly or indirectly, 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 the securities legislation of a jurisdiction in Canada as a derivatives dealer or a derivatives adviser;

"registered firm" means a registered derivatives firm or a registered securities firm;

"registered securities firm" means a person or company that is registered as a dealer, an adviser or an investment fund manager in a category of registration specified in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

"Schedule III bank" means an authorized 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 related to derivatives or derivatives party assets;

"specified commercial hedger" means a person or company described in paragraph (n) or (q) of the definition of "eligible derivatives party";

"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 qualifying clearing agency;

"valuation" means the value of a derivative as at a certain date determined in accordance with applicable accounting standards for fair value measurement using a methodology that is consistent with industry standards.

(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) all of the following apply:

(i) the second party is a limited partnership;

(ii) the first party is a general partner of the limited partnership referred to in subparagraph (i);

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(iii) the first party has the power to direct the management and policies of the second party by virtue of being a general partner of the second party;

(d) all of the following apply:

(i) the second party is a trust;

(ii) the first party is a trustee of the trust referred to in subparagraph (i);

(iii) the first party has the power to direct the management and policies of the second party by virtue of being a trustee of the second party.

(5) In this Instrument, a person or company is a subsidiary of another person or company if one of the following applies:

(a) it is controlled by

(i) the other person or company,

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

(iii) 2 or more persons or companies each of which is controlled by the other person or company;

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

(6) For the purpose of this Instrument, a person or company described in paragraph (k) of the definition of "eligible derivatives party" is an adviser acting on behalf of a managed account owned by another person or company.

(7) For the purpose of determining whether a derivatives party is an eligible derivatives party, a derivatives firm must not rely on a written representation if reliance on that representation would be unreasonable.

(8) 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*.

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PART 2
APPLICATION

Application to registered and unregistered persons or companies

2. This Instrument applies to a person or company whether or not the person or company is a registered derivatives firm or an individual acting on behalf of a registered derivatives firm.

Application – 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(8) of this Instrument. The text boxes in this Instrument do not form part of this Instrument and have no official status.

Application – affiliated entities

4. A person or company is exempt from the requirements of this Instrument in respect of dealing with or advising an affiliated entity of the person or company, other than an affiliated entity that is an investment fund.

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Application – qualifying clearing agencies

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

Application – 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.

Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party

7. (1) A derivatives firm is exempt from the requirements of this Instrument if a derivatives party is an eligible derivatives party and is neither an individual nor a specified commercial hedger, except for the following requirements,

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

(b) sections 23 [*Interaction with other Instruments*] and 24 [*Segregating derivatives party assets*];

(c) subsection 27(1) [*Content and delivery of transaction information*];

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

(2) A derivatives firm is exempt from the requirements of this Instrument in respect of a derivatives party that is an eligible derivatives party and that is an individual or a specified commercial hedger, if the eligible derivatives party has waived in writing its right to receive some or all of the protections provided under those requirements in relation to all derivatives, a class of derivatives or a specific derivative.

(3) The exemption in subsection (2) does not apply in respect of the requirements in the provisions identified in paragraphs (1)(a) to (d).

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PART 3
DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Fair dealing

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

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

Conflicts of interest

9. (1) A derivatives firm must establish, maintain and apply reasonable policies and procedures 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 a 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 facts necessary to comply with applicable 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 a derivative that has one or more 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, a derivatives firm must establish 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 (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger 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 transacts 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, or an individual acting on behalf of 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 transacts in a derivative for a derivatives party's managed account, both the derivative and the transaction are suitable for the derivatives party.

(2) If a derivatives party instructs a derivatives firm, or an individual acting on behalf of a derivatives firm, to transact in a derivative and, in the derivatives firm's reasonable opinion, following the instruction would result in a transaction or derivative that is not 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 in respect of a derivative with another person or company unless all of the following apply:

(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;

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(c) the derivatives firm, or the 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 the 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.

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 relied upon, 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.

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Handling complaints

16. A derivatives firm must document and, in a manner that a reasonable person would consider fair and effective, promptly 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.

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

The obligations in Division 3 of Part 3 do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.

Tied selling

17. (1) A derivatives firm, or an individual acting on behalf of the derivatives firm, must not impose undue pressure on or coerce a person or company to obtain a derivatives-related product or service from a particular person or company, including the derivatives firm or any of its affiliated entities, as a condition of obtaining another product or service from the derivatives firm.

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

PART 4
DERIVATIVES PARTY ACCOUNTS

DIVISION 1 – DISCLOSURE TO DERIVATIVES PARTIES

The obligations in this Division 1 of Part 4 do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.

Relationship disclosure information

18. (1) Before transacting with, for or on behalf of a derivatives party for the first time, or advising a derivatives party for the first time, 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, including all of the following:

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

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

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

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

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

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

(g) disclosure of the derivatives firm's obligations if a derivatives party has a complaint contemplated under section 16 [*Handling complaints*];

(h) 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 or at any other time or a statement identifying the exemption the derivatives firm is relying on in respect of this obligation;

(i) 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*]

(j) 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 available to the derivatives party from the derivatives firm;

(k) in the case of a derivatives firm that holds or has access to derivatives party assets, a general description of the manner in which the assets are held, used or are invested by the derivatives firm and a description of the risks and benefits to the counterparty arising from the derivatives firm holding or having access to use or invest the derivatives party assets in that manner.

(2) A derivatives firm must deliver the information in subsection (1) to the derivatives party in writing before the derivatives firm does either of the following:

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

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

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(3) If there is a significant change in respect of the information delivered to a derivatives party under subsections (1), 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 does either of the following:

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

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

(4) 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.

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

(6) A derivatives dealer referred to in subsection (5) must deliver the information required under paragraphs (1)(a) to (g) to the derivatives party in writing before the derivatives dealer first transacts in a derivative for the derivatives party.

Pre-transaction disclosure

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

(a) a general description of the type of derivatives and services related to derivatives that the derivatives firm offers;

(b) a document reasonably designed to allow the derivatives party to assess each of the following:

(i) the types of risks that a derivatives party should consider when making a decision relating to types of derivatives that the derivatives dealer offers, including the material risks relating to the type of derivatives transacted and the derivatives party's potential exposure under the type of derivatives;

(ii) 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;

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(c) a statement in writing 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. We 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, we 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.

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) Before transacting in a derivative with, for 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.

Daily reporting

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

(2) On a monthly basis, a derivatives adviser must make available to a derivatives party a valuation for each derivative that it has transacted for or on behalf of the derivatives party, unless a derivatives adviser and a derivatives party agree otherwise.

Notice to derivatives parties by non-resident derivatives firms

21. A derivatives firm whose head office or principal place of business 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 foreign jurisdiction in which the head office or the principal place of business

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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.

DIVISION 2 – DERIVATIVES PARTY ASSETS

This Division, other than sections 23 and 24, does not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is either an individual or a specified commercial hedger that has waived these protections – see section 7.

Definition – initial margin

22. In this Division, "initial margin" means any derivatives party assets delivered by a derivatives party to a derivatives firm as collateral to cover potential changes in the value of a derivative over an appropriate close-out period in the event of a default.

Interaction with other instruments

23. A derivatives firm is exempt from the requirements in this Division in respect of derivatives party assets if any of the following apply:

(a) the derivatives firm is subject to and complies with or is exempt from sections 3 to 8 of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* in respect of the derivatives party assets;

(b) the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements[1] or National Instrument 81-102 *Investment Funds* in respect of the derivatives party assets.

Segregating derivatives party assets

24. A derivatives firm must segregate derivatives party assets and derivatives positions from the property and derivatives positions of the derivatives firm and other persons or companies.

[1] This reference will be substituted with a reference to National Instrument 95-101 *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives* once it is published.

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Holding initial margin

25. A derivatives firm must hold initial margin in an account at a permitted depository.

Investment or use of initial margin

26. (1) A derivatives firm must not use or invest initial margin without receiving written consent from the derivatives party.

(2) A loss resulting from an investment or use of a derivatives party's initial margin 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 27(1), does not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is neither an individual nor a specified commercial hedger or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections – see section 7.

Content and delivery of transaction information

27. (1) A derivatives dealer that has transacted with, for or on behalf of a derivatives party must promptly deliver a written confirmation of the transaction to

(a) the derivatives party, or

(b) if the derivatives party consents or has given a direction in writing, a derivatives adviser acting for the derivatives party.

(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 required under subsection (1) must include all of the following, if and as applicable:

(a) a description of the derivative;

(b) a description of the agreement that governs the transaction;

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

(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;

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

(j) the date of the transaction;

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

Derivatives party statements

28. (1) A derivatives firm must make available a statement to a derivatives party, at the end of each quarterly period, if either of the following applies:

(a) within the quarterly period the derivatives firm transacted a derivative with, for or on behalf of the derivatives party;

(b) the derivatives party has an outstanding derivatives 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 transaction, including the number of units of the transaction, the per unit price and the total price;

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

(3) A statement delivered under this section must include all of the following information 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, as at the statement date, of each outstanding derivative referred to in paragraph (a);

(c) the final valuation, as at the expiry or termination date, of each derivative that expired or terminated during the period covered by the statement;

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

(e) any cash balance in the derivatives party's account;

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

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

PART 5
COMPLIANCE AND RECORDKEEPING

DIVISION 1 – COMPLIANCE

Definitions

29. In this Division,

"chief compliance officer" means the officer or partner of a derivatives firm that is responsible for establishing, maintaining and applying written policies and procedures to monitor and assess compliance, by the derivatives firm and individuals acting on its behalf, with securities legislation relating to derivatives;

"derivatives business unit" means, in respect of a derivatives firm, a division or 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;

"senior derivatives manager" means, in respect of a derivatives business unit of a derivatives firm, an individual designated by the derivatives firm under section 30(2).

Policies, procedures and designation

30. (1) A derivatives firm must establish, maintain and apply policies, procedures, controls and supervision sufficient to provide reasonable assurance that all of the following are satisfied:

(a) the derivatives firm and each individual acting on its behalf in relation to transacting in, or providing advice in relation to, a derivative, comply with securities legislation relating to trading and advising in derivatives;

(b) the risks relating to its derivatives activities within the derivatives business unit are managed in accordance with the derivative's firms risk management policies and procedures;

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(c) each individual who performs an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, derivatives, prior to commencing the activity and on an ongoing basis,

(i) has the experience, education and training that a reasonable person would consider necessary to perform the activity competently,

(ii) without limiting subparagraph (i), has the understanding of the structure, features and risks of each derivative that the individual transacts in or advises in relation to, and

(iii) has conducted themselves with integrity.

(2) A derivatives firm must designate a senior derivatives manager in respect of each derivatives business unit;

(3) A derivatives firm must identify to the regulator or the securities regulatory authority, upon request, each individual designated as the senior derivatives manager in respect of each derivatives business unit.

Responsibilities of senior derivatives managers

31. (1) A senior derivatives manager must do all of the following:

(a) supervise the derivatives-related activities conducted in the derivatives business unit 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 30 [*Policies, procedures and designation*];

(b) respond, in a timely manner, to any material non-compliance by an individual working in the derivatives business unit with this Instrument, applicable securities legislation or the policies and procedures required under section 30 [*Policies, procedures and designation*].

(2) At least once per calendar year, the senior derivatives manager in respect of each derivatives business unit must,

(a) prepare a report stating, as applicable, either of the following:

(i) each incidence of material non-compliance with this Instrument, securities legislation relating to trading and advising in derivatives and the policies and procedures required under section 30 [*Policies, procedures and designation*] by the derivatives business unit or an individual in the derivatives business unit and the steps taken to respond to each such incidence of material non-compliance;

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(ii) the derivatives business unit is in material compliance with this Instrument, securities legislation relating to trading and advising in derivatives and the policies and procedures required under section 30 [*Policies, procedures and designation*];

(b) submit the report referred to in paragraph (a) to the board of directors of the derivatives firm.

(3) The senior derivatives manager may not delegate its obligation under paragraph (2)(b) except to the derivatives firm's chief compliance officer.

Responsibility of derivatives firm to report material non-compliance

32. The derivatives firm must report to the regulator or the securities regulatory authority in a timely manner any circumstance in which the derivatives firm is not or was not in material compliance with this Instrument or securities legislation relating to trading and advising in derivatives and one or more of the following applies:

(a) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party;

(b) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;

(c) the non-compliance is part of a pattern of non-compliance.

DIVISION 2 – RECORDKEEPING

Derivatives party agreement

33. (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, for 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 the rights and obligations of the derivatives firm and the derivatives party.

Records

34. 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

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(i) records of derivatives party assets, and

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

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

(i) records of communications with the derivatives party relating to transacting in the derivative,

(ii) documents provided to the derivatives party to confirm the derivative, the terms of the derivative 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 each transaction relating to the derivative, including 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 for each transaction 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,

(C) any other information relevant to the transaction, and

(D) information used in calculating the derivative's valuation;

(d) an itemized record of post-transaction processing and events, including a record in relation to the calculation of margin and exchange of collateral;

(e) the price and valuation of the derivative.

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Form, accessibility and retention of records

35. (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 the derivatives firm's last outstanding derivative with the derivatives party 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 – EXEMPTION FROM THIS INSTRUMENT

Limitation on the availability of the exemption in this Division

36. The exemption in this Division is not available to a person or company if either of the following applies:

(a) the person or company is a registered derivatives firm or a registered securities firm in any jurisdiction of Canada or is registered under the commodity futures legislation of any jurisdiction of Canada;

(b) the person or company is registered under the securities, commodity futures or derivatives legislation of a foreign jurisdiction in which its head office or principal place of business is located in a category of registration 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

37. (1) A person or company is exempt from the requirements of this Instrument if all of the following apply:

(a) the person or company does not solicit or otherwise transact 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 any transaction, advise a person or company that is not an eligible derivatives party, other than general advice that is provided in accordance with the conditions of section 42 [*Advising generally*];

(c) the person or company does not regularly 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 for another person or company other than an affiliated entity that is not an investment fund;

(e) the person or company does not facilitate clearing of a derivative through the facilities of a qualifying clearing agency for another person or company.

(2) In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Foreign derivatives dealers

38. (1) A derivatives dealer whose head office or principal place of business is in a foreign jurisdiction specified in Appendix A is exempt from this Instrument in respect of a transaction if all of the following apply:

(a) it 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) it 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;

(c) it is subject to and complies with the laws of the foreign jurisdiction applicable to the derivatives dealer set out in Appendix A relating to the activities being conducted;

(d) it reports to the regulator or the securities regulatory authority in a timely manner any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to trading in derivatives that is listed in Appendix A and if any of the following applies:

(i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;

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(ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;

(iii) the non-compliance is part of a pattern of non-compliance.

(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 unless all of the following apply:

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

(b) the derivatives dealer has delivered to the derivatives party a statement in writing disclosing all of the following:

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

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

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

(iv) the name and address of the agent for service of the derivatives dealer in the local jurisdiction;

(c) the derivatives dealer has submitted to the regulator or the securities regulatory authority a completed Form 93-102F1 *Submission to Jurisdiction and Appointment of Agent for Service*;

(d) the derivatives dealer undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.

(4) A derivatives dealer that relied on the exemption in subsection (1) during the 12-month period preceding December 1 of a year must notify the regulator or 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*.

(6) A person or company is exempt from the requirements in subsections (4) and (5) if the person or company is registered as a derivatives dealer in the local jurisdiction.

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(7) In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.

(8) The requirement in paragraph (3)(b) does not apply if the derivatives party is an affiliated entity that is not an investment fund.

Investment dealers

39. A derivatives dealer that is a dealer member of IIROC is exempt from the requirements set out in Appendix B if all of the following apply:

(a) the derivatives dealer complies with the corresponding conduct and other regulatory requirements of IIROC in connection with a transaction or other related activity;

(b) the derivatives dealer promptly notifies the regulator or the securities regulatory authority of each instance of material non-compliance with a requirement or guideline

(i) to which it is subject, and

(ii) that is specified in Appendix B.

Canadian financial institutions

40. A derivatives dealer that is a Canadian financial institution is exempt from the requirements set out in Appendix C if all of the following apply:

(a) the derivatives dealer is subject to and complies with the corresponding conduct and other regulatory requirements of its prudential regulator in connection with a transaction or other related activity;

(b) the derivatives dealer promptly notifies the regulator or the securities regulatory authority of each instance of material non-compliance with a requirement or guideline

(i) to which it is subject, and

(ii) that is specified in Appendix C.

Derivatives traded on a derivatives trading facility that are cleared

41. A derivatives firm is exempt from sections 10 [*Know your derivatives party*] and 27 [*Content and delivery of transaction information*] in respect of a transaction to which all of the following apply:

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(a) the execution of the transaction is on and subject to the rules of a derivatives trading facility;

(b) as soon as technologically practicable following the transaction,

(i) the derivative is submitted for clearing to a qualifying clearing agency that provides clearing services in respect of the type of derivative, and

(ii) the derivative is accepted for clearing by the qualifying clearing agency;

(c) the derivatives firm does not know the identity of the derivatives party prior to execution of the transaction;

(d) at the time of the transaction, the derivatives party to the derivative that is submitted for clearing is an eligible derivatives party.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Advising generally

42. (1) For the purpose 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, 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) A person or company that acts as a derivatives adviser is exempt from the requirements of this Instrument applicable to 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:

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(a) the person or company;

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

(c) where the person 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 person or company were a reporting issuer.

Foreign derivatives advisers

43. (1) A derivatives adviser whose head office or principal place of business is in a foreign jurisdiction specified in Appendix D is exempt from this Instrument in respect of advice provided to a derivatives party if all of the following apply:

(a) it 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*];

(b) it 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;

(c) it is subject to and complies with the laws of the foreign jurisdiction applicable to the derivatives adviser set out in Appendix D relating to the activities being conducted; and

(d) it reports to the regulator or the securities regulatory authority in a timely manner any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to advising in derivatives, if any of the following applies:

(i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;

(ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;

(iii) the non-compliance is part of a pattern of non-compliance.

(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.

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(3) The exemption under subsection (1) is not available unless all of the following apply:

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

(b) the derivatives adviser has delivered to the derivatives party a statement in writing disclosing the following:

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

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

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

(iv) the name and address of the agent for service of the derivatives adviser in the local jurisdiction;

(c) the derivatives adviser has submitted to the regulator or the securities regulatory authority a completed Form 93-102F2 *Submission to Jurisdiction and Appointment of Agent for Service*;

(d) the derivatives adviser undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.

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

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

(6) A person or company is exempt from the requirements in subsections (4) and (5) if they are registered as a derivatives adviser in the local jurisdiction.

(7) In determining whether a person or company satisfies the conditions in subsection (1), a person or company is not required to consider activities conducted with an affiliated entity, other than an affiliated entity that is an investment fund.

(8) The requirement in paragraph (3)(b) does not apply if the derivatives party is an affiliated entity that is not an investment fund.

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PART 7
GRANTING AN EXEMPTION

Granting an exemption

44. (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

45. (1) This Instrument comes into force on [*insert date of publication + one year*].

(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 subsections (1) and (2), and except section 8 [*Fair dealing*], section 20 [*Daily reporting*] and section 28 [*Derivatives party statements*], the requirements of this Instrument do not apply in respect of a transaction if all of the following apply:

(a) the transaction was entered into before [*insert date of publication + one year*];

(b) the derivatives firm has taken reasonable steps to determine that the derivatives party is one or more of the following:

(i) a permitted client, as that term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

(ii) an accredited counterparty, as that term is defined in the *Derivatives Act* (Quebec);

(iii) a qualified party, as that term is defined in any of the following:

(A) Alberta Blanket Order 91-507 *Over-the-Counter Derivatives*;

(B) British Columbia Blanket Order 91-501 *Over-the-Counter Derivatives*;

(C) Manitoba Blanket Order 91-501 *Over-the-Counter Trades in Derivatives*;

(D) New Brunswick Local Rule 91-501 *Derivatives*;

(E) Nova Scotia Blanket Order 91-501 *Over-the-Counter Trades in Derivatives*;

(F) Saskatchewan General Order 91-908 *Over-the-Counter Derivatives*.

INCLUDES COMMENT LETTERS

INCLUDES COMMENT LETTERS

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

FOREIGN DERIVATIVES DEALERS
(Section 38)

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**

[To be completed]

INCLUDES COMMENT LETTERS

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

IIROC DEALER MEMBERS
(Section 39)

[To be completed]

INCLUDES COMMENT LETTERS

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

CANADIAN FINANCIAL INSTITUTIONS
(Section 40)

[To be completed]

INCLUDES COMMENT LETTERS

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

FOREIGN DERIVATIVES ADVISERS
(Section 43)

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

[To be completed]

INCLUDES COMMENT LETTERS

ANNEX III

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* (**NI 14-101**). "Securities legislation" is defined in NI 14-101, 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*;

"regulator" means the regulator or securities regulatory authority in a jurisdiction.

INCLUDES COMMENT LETTERS

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* (**NI 45-106**) with one exception. The definition of this term in NI 45-106 does not include a Schedule III bank (due to the separate definition of the term "bank" in NI 45-106), with the result that NI 45-106 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.

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

Section 1 – Definition of commercial hedger

The concept of "commercial hedger" is meant to apply to a business entering into a transaction for the purpose of managing risks inherent in its business. This could include, for example, a commodity producer managing risks associated with fluctuations in the price of the commodity it produces or a company entering into an interest rate swap to hedge its interest rate risks associated with a loan obligation. It is not intended to include a circumstance where the commercial enterprise enters into a transaction for speculative purposes; there has to be a significant link between the transaction and the business risks being hedged.

Paragraphs (n) and (q) of the definition of "eligible derivatives party" provide that a commercial hedger will qualify as an eligible derivatives party if it meets the conditions in those paragraphs.

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 it is 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 it is either of the following:

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

- 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* (**NI 93-102**).

INCLUDES COMMENT LETTERS

Factors in determining a business purpose – derivatives dealer

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. Several factors that we consider relevant are described below. This is not a complete list and other factors may also be considered.

- *Acting as a market maker* – Market making is generally understood as the practice of routinely standing ready to transact derivatives by

  - responding to requests for quotes on derivatives, or

  - making quotes available to other persons or companies that seek to transact derivatives, whether to hedge a risk or to speculate on changes in the market value of the derivative.

  Market makers are typically compensated for providing liquidity through spreads, fees or other compensation, including fees or compensation paid by an exchange or a trading facility that do not relate to the change in the market value of the derivative transacted. A person or company that contacts another person or company about a transaction to accommodate its own risk management needs or to speculate on the market value of a derivative will not, typically, be considered to be acting as a market maker.

  A person or company will be considered to be "routinely standing ready" to transact derivatives if it is responding to requests for quotes or it is making quotes available with some frequency, even if it is not on a continuous basis. Persons or companies that respond to requests or make quotes available occasionally are not "routinely standing ready".

  A person or company would also typically be considered to be a market maker when it holds itself out as undertaking the activities of a market maker.

  Engaging in bilateral discussions relating to the terms of a transaction will not, on its own, constitute market making activity.

- *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 its sole or even primary endeavour for it 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.

- *Facilitating or intermediating transactions* – The person or company provides services relating to the facilitation of trading or intermediation of transactions between third-party counterparties to derivatives contracts.

INCLUDES COMMENT LETTERS

- *Transacting with the intention of being compensated* – The person or company receives, or expects to receive, any form of compensation for carrying on transaction activity. This would include any compensation that is transaction or value-based including compensation 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 transactions* – The person or company directly solicits 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 would include providing quotes to derivatives parties or potential derivatives parties that are not provided in response to a request. 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, unless it is the person or company's intention or expectation to be compensated as a result of the contact. For example, a person or company that wishes to hedge a specific risk is not necessarily soliciting for the purpose of the Instrument if it contacts multiple potential counterparties to enquire about potential 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 it is, for the purposes of the Instrument, a derivatives dealer, a person or company should consider its 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.

Factors in determining a business purpose – derivatives adviser

Under securities legislation, a person or company engaging in or holding itself out as engaging in the business of advising others in relation to derivatives is generally required to register as a derivatives adviser unless an exemption is available.

INCLUDES COMMENT LETTERS

As with the definition of "derivatives dealer", the definition of "derivatives adviser" (and the definition of "adviser" in securities legislation generally) requires an assessment of whether the person or company is "in the business" of conducting an activity. In the case of derivatives advisers, it is necessary to determine whether a person or company is "advising others" in relation to derivatives.

As with derivatives dealers, a person or company that is determining whether or not it is a derivatives adviser should consider its 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.

The definition of "derivatives adviser" also contains an additional element that the derivatives adviser should be in the business of "advising others" in relation to derivatives. Examples of persons and companies that may be considered to be in the business of advising others in relation to derivatives include the following:

- a registered adviser under securities or commodity futures legislation that provides advice to an investment fund or another person or company in relation to derivatives or derivatives trading strategies;

- a registered adviser under securities or commodity futures legislation that manages an account for a client and makes trading decisions for the client in relation to derivatives or derivatives trading strategies;

- an investment dealer that provides advice to clients in relation to derivatives or derivatives trading strategies;

- a person or company that recommends a derivative or derivatives trading strategy to investors as part of a general solicitation by an online derivatives trading platform.

A person or company that discusses the merits of a particular derivative or derivatives trading strategy in a newsletter or on a website may be considered to be advising others in relation to derivatives but would be exempt if it meets the conditions in section 42 [*Advising generally*].

Similarly, a derivatives dealer that recommends a particular derivative or derivatives trading strategy to a customer in connection with a proposed transaction may be considered to be advising the customer in relation to derivatives. However, so long as the derivatives dealer is appropriately registered and has the necessary proficiency to provide the advice (or is otherwise exempt from registration), the derivatives dealer does not need to also register as a derivatives adviser.

If the derivatives firm's trading or advising activity is incidental to the firm's primary business, we may not consider it to be for a business purpose. For example, appropriately licensed professionals, such as lawyers, accountants, engineers, geologists and teachers, may provide advice in relation to derivatives in the normal course of their professional activities. We would generally not consider them to be advising on derivatives for a business purpose if such activities are incidental to their *bona fide* professional activities.

INCLUDES COMMENT LETTERS

Factors in determining a business purpose – general

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. 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 purposes of the Instrument.

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 derivatives dealer or a derivatives adviser in a local jurisdiction is a person or company that conducts the described activities 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 activities 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 activities with a derivatives party located in the local jurisdiction.

Where dealing or advising activities are provided to derivatives parties in a local jurisdiction or where dealing or advising activities are otherwise conducted within a local jurisdiction, regardless of the location of the derivatives party, we would generally consider a person or company to be a derivatives dealer or derivatives adviser.

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.

Section 1 – Definition of derivatives party

The term "derivatives party is similar to the concept of a "client" in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registration Obligations* (**NI 31-103**). We have used the term "derivatives party" instead of "client" to reflect the circumstance where the derivatives firm may not regard its counterparty as its "client."

Section 1 – Definition of eligible derivatives party

The term "eligible derivatives party" is intended to refer to those derivatives parties that have the requisite knowledge and experience to evaluate the information about derivatives that has been provided to the person or company by the derivatives firm. These persons or companies may not require the full set of protections that are provided to other derivatives parties that are not eligible derivatives parties.

INCLUDES COMMENT LETTERS

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

A derivatives firm should take reasonable steps to determine if a derivatives party is an eligible derivatives party. In determining whether the person or company that it transacts with, solicits 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 representations.

Section 1 – Definition of eligible derivatives party – paragraphs (m) to (q)

Under paragraphs (m) to (q) of the definition of "eligible derivatives party", a person or company will only be considered to be an eligible derivatives party if it has made certain representations to the derivatives firm in writing.

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

We expect that a derivatives firm would maintain a copy of each derivatives party's written representations that is relevant to 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. Subsection 1(7) provides that a derivatives firm must not rely on such a written representation if reliance on that representation would be unreasonable. See subsection 1(7) of this Policy for further guidance.

For the purposes of paragraphs (m) and (n), net assets must have an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, that are more than the prescribed threshold ($25 000 000 in paragraph (m) and $10 000 000 in paragraph (n)) or an equivalent amount in another currency. Unlike in paragraph (o), assets considered for the purposes of paragraphs (m) and (n) are not limited to "financial assets".

A person or company is only an eligible derivative party under paragraphs (n) and (q) if the person or company has, at the time the transaction occurs, represented to be a commercial hedger. The derivatives firm may rely on a written representation from the derivatives party that it is a commercial hedger for the derivatives it transacts with the derivatives firm unless a reasonable person would have grounds to believe that the statement is false or it is otherwise unreasonable to believe that the representation is accurate. This representation may be tailored by the eligible derivatives party and the derivatives firm to provide for specific derivatives or types of derivatives.

In the case of paragraph (o), the individual must beneficially own financial assets, as that term is defined in section 1.1 of NI 45-106, that have an aggregate realizable value before tax but net of any related liabilities of at least $5 000 000 (or an equivalent amount in another currency).

INCLUDES COMMENT LETTERS

"Financial assets" is defined to include cash, securities or a deposit, or an evidence of a deposit that is not a security for the purposes of securities legislation.

Paragraph (p) of the definition of "eligible derivatives party" provides that a derivatives firm may treat a derivatives party as an eligible derivatives party if the derivatives party represents to the derivatives firm that all of its obligations under a derivative are guaranteed or otherwise fully and unconditionally supported (under a letter of credit or credit support agreement) by one or more eligible derivatives parties, other than eligible derivatives parties qualifying as such under paragraph (n) or (o).

Subparagraph (q)(ii) of the definition of "eligible derivatives party" is similar to paragraph (p), but does not exclude qualifying guarantors or credit support providers that are eligible derivatives parties under paragraph (n).

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 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.[1] As of the time of the publication of this Instrument the following countries and their political subdivisions are permitted jurisdictions: 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[2] and countries using the euro under a monetary agreement with the European Union.[3]

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[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).

[2] 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).

[3] 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).

INCLUDES COMMENT LETTERS

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* (**NI 94-102**), 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.

Section 1 – Definition of valuation

The term "valuation" is defined to mean the value of a derivative determined in accordance with accounting principles for fair value measurement that are consistent with accepted methodologies within the derivatives firm's industry. Where market quotes or market-based valuations are unavailable, we expect the value to represent the current mid-market level derived from market-based metrics incorporating a fair value hierarchy. The mid-market level does not have to include adjustments incorporated into the value of a derivative to account for the characteristics of an individual counterparty.

Subsection 1(7) – Relying on a written representation unless unreasonable to do so

Whether it is reasonable for a derivatives firm to rely on a derivatives 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 derivatives 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
- publicly available financial information.

INCLUDES COMMENT LETTERS

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 that, under securities legislation is

- registered as a "derivatives dealer" or "derivatives adviser",
- exempt from the requirement to register as a "derivatives dealer" or "derivatives adviser", and
- excluded from registration as a "derivatives dealer" or "derivatives adviser".

Accordingly, derivatives firms that may be exempt from the requirement to register in a jurisdiction, such as Canadian financial institutions and individuals acting on their behalf in relation to transacting in, or providing advice in relation to, a derivative, will nevertheless be subject to the same standard of conduct towards their derivatives parties that apply to registered derivatives firms and their registered representatives.

Section 3 – Scope of instrument

Section 3 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 purposes of the Instrument.

Section 6 – Governments, central banks and international organizations

Section 6 provides that the Instrument does not apply to certain governments, central banks and international organizations specified in the section. Section 6 does not, however, exclude derivatives firms that deal with or advise these entities from the application of the Instrument.

Section 7 – Exemptions from the requirements of this Instrument when dealing with or advising an eligible derivatives party

We are of the view that, because of their nature, regulatory oversight, financial resources or experience, eligible derivatives parties do not require the full set of protections afforded to derivatives parties that are not eligible derivatives parties (we refer to them as **non-eligible derivatives parties**).

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

INCLUDES COMMENT LETTERS

Dealing with or advising a derivatives party that is a non-eligible derivatives party

If a derivatives firm is dealing with or advising a non-eligible derivatives party, no exemption is available from the requirements in Parts 3, 4 and 5.

Dealing with or advising an eligible derivatives party that is not an individual or a specified commercial hedger

A derivatives firm is exempt from the requirements of the Instrument if it is dealing with or advising a derivatives party that is an eligible derivatives party that is not an individual or a specified commercial hedger, except for the following:

- in Part 3 [*Dealing with or advising derivatives parties*], all of the requirements in Division 1 [*General obligations towards all derivatives parties*]:
  - section 8 [*Fair dealing*],
  - section 9 [*Conflicts of interest*], and
  - section 10 [*Know your derivatives party*];

- in Part 4, Division 2 [*Derivatives party assets*]:
  - section 23 [*Interaction with other instruments*], and
  - section 24 [*Segregating derivatives party assets*];

- in Part 5 [*Compliance*]:
  - all of Division 1 – [*Compliance*], and
  - all of Division 2 – [*Recordkeeping*].

Dealing with or advising an eligible derivatives party that is an individual or a specified commercial hedger

Under subsection 7(2), a derivatives firm is exempt from certain requirements in the Instrument in respect of dealing with or advising an eligible derivatives party that is an individual or a specified commercial hedger if the eligible derivatives party waives, in writing, one or more of those requirements. Subsection 7(3) specifies certain requirements that cannot be waived by the eligible derivatives party for the purpose of the exemption in subsection 7(2). The eligible derivatives party that is an individual or a specified commercial hedger can waive specific requirements for a derivative, a type of derivatives or for all derivatives. For example a producer of a certain commodity may choose to waive certain requirements in relation to derivatives where the underlying asset is a commodity that they produce but may not want to waive protections in relation to other types of derivatives.

A written waiver contemplated under subsection 7(2) may be made by an eligible derivatives party that is an individual or a specified commercial hedger as part of account-opening documentation. For clarity, there is no obligation under the Instrument to update the waiver after it is made. However, it is always open to an eligible derivatives party that is an individual or a specified commercial hedger to withdraw, in whole or in part, any waiver it has made to a derivatives firm.

INCLUDES COMMENT LETTERS

There is no prescribed form for the waiver contemplated by subsection 7(2). 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 clear and meaningful manner in order to ensure the derivatives party understands the information presented and the significance of the protections being waived. We would consider it to be a breach of section 8 [*Fair Dealing*] to put unreasonable pressure on any derivatives party to waive any requirements. We would also expect the derivatives firm to remind the derivatives party that it has the option to obtain independent advice before signing the waiver.

PART 3
DEALING WITH OR ADVISING DERIVATIVES PARTIES

DIVISION 1 – GENERAL OBLIGATIONS TOWARDS ALL DERIVATIVES PARTIES

Section 8 – Fair dealing

The obligation in section 8 (the **fair dealing obligation**) is a principles-based obligation and is intended to be similar to the duty to act fairly, honestly and in good faith applicable to registered firms and registered individuals under securities legislation (the **registrant fair dealing obligation**).[1]

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. 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 interpreted differently if the derivatives party is an individual or small business than from

[1] 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]**.

INCLUDES COMMENT LETTERS

how it would be interpreted if the derivatives party is 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 derivative as principal where it would be expected that each party negotiating the derivative is seeking to ensure favourable financial terms.

When a derivatives firm is dealing with or advising an eligible derivatives party, we generally interpret the fair dealing obligation in section 8 in a similar manner to the “fair and balanced communications” obligation as it is conceived in the context of similar rules in the United States.

Abusive practices, including fraud, price fixing, manipulation of benchmark rates, and front-running of trades are violations of securities legislation; we take the view that each of these would be a severe breach of the fair dealing obligation.

Derivatives firms have an obligation to transact with a derivatives party under terms that are fair. What constitutes “fair” will vary depending on the particular circumstances. Misrepresenting the nature of the product and related risks, or deliberately selling a derivative that is not suitable for a derivatives party, would not be considered to be “fair” and, in our view, would be a breach of the fair dealing obligation. We also expect the derivatives firm to provide a derivatives party with information about the implications of terminating a derivative prior to maturity, including potential exit costs. As part of the policies and procedures required under section 30, a derivatives firm is expected to be able to demonstrate that it has established and follows policies and procedures that are reasonably designed to achieve fair terms, in the context, for the derivatives firm’s derivatives parties and that these policies and procedures are reviewed regularly and amended as required.

We interpret the fair dealing obligation to include determining prices for derivatives transacted with derivatives parties in a fair and equitable manner. We expect there to be a rational basis for a discrepancy in price where essentially the same derivative is transacted with different derivatives parties. Factors that indicate a rational basis could include the level of counterparty risk of a derivatives party, the derivatives party’s trading activity, or relationship pricing. Lack of sophistication, knowledge or understanding about a derivatives product should never be a factor in providing less advantageous pricing. Both the compensation component and the market value or price component of the derivative are relevant in determining whether the price for a derivatives party is fair. A derivatives firm’s policies and procedures under section 30 must address how both the price of the derivative as well as the reasonableness of compensation are determined. A derivatives party should be given an opportunity, at their option, to obtain independent advice before transacting in a derivative.

Derivatives firms are expected to obtain information from each derivatives party to allow them to meet their fair dealing obligation.

Section 9 – Conflicts of interest

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.

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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 example, a derivatives firm and the derivatives party with which it transacts bilaterally hold opposing positions under the same derivative and this may represent an inherent conflict of interest in the narrow context of that specific derivative. We recognize, therefore, that it may not necessarily be appropriate to apply the conflict of interest provisions under the Instrument to derivatives market participants in the same manner as the relevant conflict of interest provisions would apply to securities market participants.

We take the view that a 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 viewed differently when dealing with a non-eligible derivative party that is an individual or a small business than they would be viewed if the derivatives party were an eligible derivatives party, which may be different again from how conflicts of interest would be viewed if the derivatives 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 eligible derivatives party is reasonably aware that the derivatives firm is seeking terms favourable to its own interests.

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, to both the derivatives firm and a derivatives party, that a conflict of interest raises, and
- respond appropriately to conflicts of interest.

When responding to any conflict of interest, we expect the derivatives firm to consider the fair dealing obligation in section 8 as well as any other standard of care that may apply when dealing with or advising a derivatives party.

We are of the view that there are three methods that are generally reasonable to respond to a conflict of interest, depending on the circumstances: avoidance, control and disclosure.

We expect that if there is a risk of material 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 there is not a risk of material harm and the derivatives firm does not avoid the conflict of interest, we

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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. We are generally of the view that conflicts that have a lesser impact on the interests of a derivatives party can be managed through controls or disclosure.

Where conflicts of interest between a derivatives party and a derivatives firm cannot be managed using controls or disclosure, we expect the derivatives firm to avoid the conflict. This may require the derivatives firm to stop providing the service or stop transacting derivatives with, or providing advice in relation to derivatives to, the derivatives party.

Controlling conflicts of interest

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

- 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.

Depending on the conflict of interest, a derivatives firm may be able to reasonably respond to the conflict of interest by controlling the conflict in an appropriate way. This may include

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

Where a conflict of interest is such that no control is effective, we expect the conflict to be avoided.

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Subsection 9(3) – Disclosing conflicts of interest

When disclosure is appropriate

We expect a derivatives firm to inform each derivatives party it transacts derivatives with, or provides advice in relation to derivatives to, about any conflicts of interest that could affect the services the firm provides to the derivatives party.

Timing of disclosure

Under subsection 9(3), a derivatives firm and individuals acting on its behalf must disclose a conflict of interest in a timely manner. We expect a derivatives firm and its representatives to disclose the conflict 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.

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.

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We 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.

More specifically, we would generally expect that disclosures would be separated into two categories:

(i) general conflicts of interest disclosures applicable to all counterparties (those which affect all counterparties and transaction types, addressed in a written general disclosure) that could be disclosed to counterparties on an annual basis, and

(ii) disclosures specific to a counterparty or a specific contemplated transaction (i.e., disclosure regarding specific conflicts of interest that are material and specific to a counterparty or a particular transaction prior to entering into a transaction) by providing written notice of or disclosing the conflict to a trader of their derivatives party over a taped line prior to trading.

We recognize that it may be appropriate in some circumstances for a derivatives firm to disclose a conflict where it arises after the original transaction has taken place. This might arise, for example, in the case of an equity total return swap where subsequent to entering into a transaction with a derivatives party, the derivatives dealer becomes an a mergers and acquisitions adviser in respect of the equity underlier (where the proposed merger and acquisitions activity has been announced).

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

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that a derivatives firm will have internal policies and procedures to evaluate the balance of these interests.

Acting on behalf of derivatives parties

When a derivatives firm, or the individuals acting on its behalf, exercise discretionary authority over the accounts of its derivatives parties to enter into transactions on their behalf, we would expect the derivatives firm to have policies and procedures to address the potential conflicts of interest ensuing from the contractual relationship governing the exercise of discretionary authority.

Compensation practices

We expect that a derivatives firm would consider whether any 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.

Section 10 – Know your derivatives party

Derivatives firms act as gatekeepers of the integrity of the derivatives markets. They should not, by act or omission, facilitate conduct that brings the market into disrepute. As part of their gatekeeper role, derivatives firms are required to establish the identity of, and conduct due diligence on, their clients or counterparties under the know-your-derivatives party obligation in section 10 (the "**KYDP obligation**"). Complying with this obligation can help ensure that derivatives transactions are completed in accordance with securities laws.

The KYDP obligation requires derivatives firms to take reasonable steps to obtain and periodically update information about their derivatives parties.

Section 41 provides an exemption for derivatives firms from the obligations under this section for transactions that are executed on a derivatives trading facility and that are cleared.

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 neither an individual nor a specified commercial hedger or an eligible derivatives party that is an individual or specified commercial hedger that has waived these obligations.

Section 11 – Derivatives-party-specific needs and objectives

Information on a derivatives party's specific needs and objectives (referred to below as "**derivatives-party-specific KYC information**") forms the basis for determining whether transactions are suitable for a derivatives party. The obligations in section 11 require a derivatives

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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 fair terms of a derivative for a derivatives party under subsection 8(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 the impact of making a trading interest public.

Before transacting with a derivatives party, we expect a derivatives firm to have the appropriate information 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, we would expect the derivatives party to be notified. The derivatives firm would be expected to advise the derivatives party that

- this information is required to determine whether the derivative is suitable for the derivatives party, and
- without this 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 derivative.

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

The extent of derivatives-party-specific KYC information that a derivatives firm needs in order 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.

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In some cases, a derivatives firm will need extensive derivatives-party-specific 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

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

In other cases, a derivatives firm may need to obtain less derivatives-party-specific 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 with or for, or recommends 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 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 a derivatives firm to be able to demonstrate a process for making suitability determinations that are appropriate under the circumstances.

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Suitability obligations cannot be delegated

A derivatives firm should not

- delegate its suitability obligations to anyone other than an officer or employee of the derivatives firm, 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 specific needs and objectives and suitability

The conduct obligations set out in the Instrument, including the derivatives-party-specific KYC and suitability obligations in sections 11 and 12, are intended to be "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 a derivatives firms' obligations pursuant to sections 11 and 12 is solicited through an online service or questionnaire, we expect that this process would amount to a meaningful discussion with the derivatives party.

An online service or questionnaire is expected to achieve this objective if it

- uses a series of behavioural questions to establish risk tolerance and elicit other derivatives-party-specific 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 inconsistencies or conflicts are resolved,
- offers information about the terms and concepts involved, and
- 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's name and contact information to an individual or a firm. "Referral fee" is also broadly defined. It includes any benefits received from referring a derivatives party, including sharing or splitting any commission resulting from a transaction.

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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 specific contents of the disclosure to be provided to referred derivatives parties, and
- who provides the disclosure to referred derivatives parties.

If the person or company receiving the referral is a derivatives firm or an individual acting on behalf of that derivatives firm, they would be responsible for carrying out all obligations of a derivatives firm towards the referred derivatives party in respect of the derivatives-related activities for which the derivatives party is referred and communicating with the referred derivatives party. However, if the referring person or company is a derivatives firm, the referring derivatives firm is still required to comply with sections 13 [*Permitted referral arrangements*], 14 [*Verifying the qualifications of the person or company receiving the referral*] and 15 [*Disclosing referral arrangements to a derivatives party*].

If a derivatives party is referred by or to an individual acting on behalf of a derivatives firm, we expect the derivatives firm to be a party to the referral agreement. This ensures that the derivatives firm is aware of these arrangements so it can adequately supervise the individuals acting on its behalf and monitor compliance with the agreements. It 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 itself does not constitute an activity that the derivatives firm is not authorized to engage in.

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

Section 14 requires the derivatives firm, or individual acting on its behalf, 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, or individual acting on its behalf, is responsible for determining the steps that are reasonable in the circumstances. For example, this may include an assessment of the types of derivatives parties that the referred services would be appropriate for.

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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 the 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 is directly participating in the referral arrangement, to take reasonable steps to ensure that a derivatives party understands

- which entity it is dealing with,
- what it can expect that entity to provide to it,
- the derivatives firm's key responsibilities to it,
- if applicable, the limitations of the derivatives firm's registration category or exemptive relief,
- if applicable, any relevant terms and conditions imposed on the derivatives firm's registration or exemptive relief,
- 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 16 – Handling complaints

General duty to document and respond to complaints

Section 16 requires a derivatives firm to document complaints and to effectively, fairly and promptly 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

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 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,

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- 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 system 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 that is the subject of a complaint, 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, promptly in writing:

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

Timeline for responding to complaints

We expect that a derivatives firm would

- promptly send an initial written response to a complainant within 5 business days of receipt of the complaint, and

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- 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 CERTAIN 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 neither an individual nor a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

Section 17 – Tied selling

Section 17 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 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 17 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 17 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.

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 a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

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Section 18 – Relationship disclosure information

Content of relationship disclosure information

The Instrument does not prescribe a form for the relationship disclosure information required under section 18. 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 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 18(1), an individual acting on behalf of a derivatives firm must spend sufficient time with a derivatives party in a manner consistent with their operations to adequately explain the relationship disclosure information that is delivered to the derivatives party. 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 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.

Paragraphs 18(1)(a) to (k) – Required relationship disclosure information

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

Under paragraph 18(1)(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 particular, we 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. Under paragraph 18(1)(n) the derivatives firm must disclose how the derivatives party assets will be held, used and invested.

We 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.

Describe the conflicts of interest

Under paragraph 18(1)(b) 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

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is in section 9, 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.

Disclosure of charges, fees and other compensation

Paragraphs 18(1)(c), (d) and (e) require a derivatives firm to provide a derivatives party information on fees and costs they might be charged when entering into a transaction. 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.

We also expect a derivatives firm to provide the derivatives party with general information on any transaction and other charges that a derivatives party may be required to pay, including general information about potential break costs if a derivative is terminated prior to maturity, as well as other compensation the derivatives firms may receive from a third party as a result of their business relationship.

We recognize that a derivatives firm may not be able to provide all information about the costs associated with a particular derivative or transaction until the terms of the derivative have been agreed upon. However, before entering into an initial transaction, a derivatives firm must meet the applicable pre-transaction disclosure requirements in section 19.

Description of content and frequency of reporting

Under paragraph 18(1)(f) 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 20,
- transaction confirmations under section 27, and
- derivatives party statements under section 28.

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 18(1)(i) requires a derivatives firm to disclose the type of information that it must collect from the derivatives party. We expect this disclosure will also indicate how this information will be used in assessing and determining the suitability of a derivatives party transaction.

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Section 19 – Pre-transaction disclosure

The Instrument does not prescribe a form for the pre-transaction disclosure that must be provided to a derivatives party under section 19. 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 19(1) must be delivered to the derivatives party at a reasonably sufficient time prior to entering into the first transaction with the derivatives firm to allow the derivatives party to assess the material risks and material characteristics of the type of derivative transacted. This disclosure document may be communicated by email or other electronic means.

Identify the derivatives-related products or services the derivatives firm offers

Under paragraph 19(1)(a), a derivatives firm must provide a general description of the derivatives products and services related to derivatives that 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. The information required to be delivered under paragraph 19(1)(a) may be provided orally or in writing.

Describe the types of risks that a derivatives party should consider

Paragraph 19(1)(b)(i) requires 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. The risks disclosed may include market, credit, liquidity, operational, legal and currency risks, as applicable.

The information required to be delivered under paragraph 19(1)(b) may be provided orally or in writing.

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

Paragraph 19(1)(c) 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 derivatives parties are only required to deposit a percentage of the total value of the derivative 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 the total value of the derivative. This means leverage magnifies a derivatives party's profit or loss on a transaction, and losses can exceed the amount of funds deposited.

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Subsection 19(2) – Disclosure before transacting in a derivative

We understand that the use of the term "price" is not always appropriate in relation to a derivative or transaction in a derivative. Therefore, under paragraph 19(2)(b), disclosure with respect to spreads, premiums, costs, etc., could be more appropriate than the price.

Section 20 – Daily reporting

We do not expect a derivatives dealer to make the daily mid-market mark (or valuation) available to a derivatives party for a derivative that is cleared through a regulated clearing agency because we expect that derivatives parties will already be able to access valuation information from the clearing agency. However, we would expect the derivatives dealer to notify the derivatives party of its right to request and receive the clearing agency's daily mid-market mark.

Section 21 – Notice to derivatives parties by non-resident derivatives firms

The notice required under section 21 may be provided by a derivatives firm to a derivatives party in standard form industry documentation; a separate statement is not required to be provided to satisfy the obligations of this section.

DIVISION 2 – DERIVATIVES PARTY ASSETS

Section 23 – Interaction with other instruments

A derivatives firm is exempt from the requirements of this Division in respect of derivatives party assets if the derivatives firm is subject to and complies with or is exempt from sections 3 to 8 of NI 94-102 in respect of the derivatives party assets. The exemption from the requirements of this Division set out in paragraph (a) also extends to derivatives firms that rely on substituted compliance under NI 94-102.

A derivatives firm is exempt from the requirements of this Division in respect of derivatives party assets if the derivatives firm is subject to and complies with securities legislation relating to margin and collateral requirements or National Instrument 81-102 *Investment Funds* in respect of derivatives party assets. The exemption from the requirements of this Division on this basis extends to derivatives firms that rely on exemptions from the requirements under securities legislation relating to margin and collateral requirements.

Section 24 – Segregating derivatives party assets

A derivatives firm is required to segregate derivatives party assets from its own property and from the property of the firm's other derivatives parties either by separately holding or accounting for derivatives party assets.

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Section 25 – Holding initial margin

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

- 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 immobilized or dematerialized 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 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 initial margin, 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 26– Investment or use of initial margin

Section 26 requires that a derivatives firm receive written consent from a derivatives party before investing or otherwise using collateral provided as initial margin. In order to provide consent a derivatives party needs to be made aware of and agree to any potential investment or use. If applicable, we would expect such disclosure to take the form of the disclosures contemplated by paragraph 18(1)(k) [*Relationship disclosure information*], which requires the derivatives firm to disclose the manner in which the assets are used or invested and to provide a description of the risks and benefits to the derivatives party that arises from the derivatives firm having access to use or invest derivatives party assets.

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DIVISION 3 – REPORTING TO DERIVATIVES PARTIES

The obligations in this Division, other than subsection 27(1) [*Content and delivery of transaction information*], do not apply if a derivatives firm is dealing with or advising an eligible derivatives party that is not an individual or a specified commercial hedger or an eligible derivatives party that is an individual or a specified commercial hedger that has waived these obligations.

Section 27– Content and delivery of transaction information

The requirement to provide a written confirmation under subsection 27(1) can be satisfied by electronic confirmations (including SWIFT confirmations).

We are of the view that the written description of the derivative transacted required by paragraph 27(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 28 – Derivatives party statements

We are of the view that the description of the derivative transacted required by paragraphs 28(2)(b) and 28(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

The objective of this Division is to further a culture of compliance and personal accountability within a derivatives firm. Section 31 imposes certain obligations on a senior derivatives manager, further discussed below, with respect to ensuring compliance by individuals performing activities relating to transacting in, or advising in relation to, derivatives within the area of the business the senior derivatives manager is responsible for, which is referred to in the Instrument and below as a “derivatives business unit”.

Sections 30 and 32 set out certain obligations on the derivatives firm regarding policies and procedures relating to compliance and responding to material non-compliance. We are of the view that a derivatives firm should be afforded flexibility with respect to who fulfills these obligations of the derivatives firm. The obligations on the derivatives firm under these sections may be carried out by, for example, one or more senior derivatives managers designated by the derivatives firm.

Section 29 – Definitions

The definition of “derivatives business unit” is not intended to dictate that a derivatives firm must organize its derivatives activity in any particular organizational structure. A derivatives business

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unit could relate to any of, or any combination of, a class of derivatives, an asset class or sub-asset class, a geographic territory, a business line or a division of the derivatives firm.

The definition of "senior derivatives manager" refers to the individual designated as primarily responsible for a particular derivatives business unit. This definition is intended to lead to the designation of the individual who is responsible for

- implementing, within the derivatives business unit, management business priorities within the risk parameters that have been established by the department that is responsible for the management of risk of the derivatives firm, and,

- operationalizing, within the derivatives business unit, policies and procedures relating to compliance established by the department that is responsible for compliance of the derivatives firm.

We generally expect that the individual designated as the senior derivatives manager of a derivatives business unit would have regular interactions with the individuals in the derivatives business unit. We interpret "regular" in this context to mean day-to-day and not to mean infrequent but regular, e.g., once per quarter. Therefore, our expectation is that a senior derivatives manager will be an individual informed of and, in some cases, involved with, the day-to-day activities within the derivatives business unit.

Depending on its size, level of derivatives activity and organizational structure, a derivatives firm may have a number of different derivatives business units. Further, the specific title or job description of the individual designated as "senior derivatives manager" for a derivatives business unit could vary between derivatives firms, depending once again on their size, level of derivatives activity and organizational structures.

Except in a small derivatives firm, we would not expect a senior derivatives manager to be the chief executive officer of the derivatives firm, or an individual registered under NI 93-102 (if applicable) as any of the derivatives ultimate designated person, derivatives chief compliance officer or derivatives chief risk officer of the derivatives firm. In a smaller firm, some of these roles may be assigned to the same individual or individuals.

In a large derivatives firm, we would also generally expect that a senior derivatives manager would not be the officer in charge of the division of the derivatives firm that conducts the activities that result in the firm meeting the definition of "derivatives dealer" or "derivatives adviser" in the Instrument.

It is the responsibility of the derivatives firm to identify within the organizational structure of their business the individual that should be designated as the senior derivatives manager of a derivatives business unit.

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Section 30 – Policies, procedures and designation

Section 30 requires a derivatives firm to establish, maintain and apply policies and procedures and a system (i.e., a "**compliance system**") of controls and supervision sufficient to provide reasonable assurance that

- the derivatives firm and those acting for it, as applicable, comply with applicable securities legislation,
- the derivatives firm and each individual acting on its behalf manage derivatives-related risks prudently,
- individuals performing a derivatives-related activity on behalf of the firm, prior to commencing the activity and on an ongoing basis,
  - possess the experience, education and training that a reasonable person would consider necessary to perform these activities in a competent manner, and
  - conduct themselves with integrity.

We expect that the policies, procedures and controls referred to in section 30 would include internal controls and monitoring that are reasonably likely to identify non-compliance at an early stage and would allow the derivatives firm to correct non-compliance in a timely manner.

We do not expect that the policies, procedures and controls referred to in section 30 would be applicable to derivatives firm's activities other than its activities relating to transacting in, or advising in relation to, derivatives. For example, a derivatives dealer may also be a reporting issuer. The policies, procedures and controls established to monitor compliance with the Instrument would not necessarily reference matters related only to the derivatives firm's status as a reporting issuer. Nevertheless, a derivatives firm would not be precluded from establishing a single set of policies, procedures and controls related to the derivatives firm's compliance with all applicable securities laws.

We interpret "risks relating to its derivatives activities" in paragraph 30(1)(b) to include the risks inherent in derivatives trading (including credit risk, counterparty risk, and market risk) that relate to a derivatives firm's overall financial viability.

Paragraph 30(1)(c) – Policies and procedures relating to individuals

Paragraph 30(1)(c) establishes a reasonable person standard with respect to proficiency, rather than prescribing specific courses or other training requirements. However, we note that a derivatives firm and an individual transacting in, or providing advice in relation to, a derivative on behalf of the derivatives firm may be subject to more specific education, training and experience requirements, including under NI 93-102, if applicable.

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Subparagraph 30(1)(c)(i) contemplates that industry experience can be a substitute for formal education and training. We are of the view that this is particularly relevant in respect of formal education and training prior to commencing an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative. However, we expect that all individuals who perform such activity receive appropriate training on an ongoing basis.

Subparagraph 30(1)(c)(iii) relates to integrity of the individuals who perform an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative. Prior to employing an individual in a derivatives business, we expect that a derivatives firm will assess the integrity of the individual by having regard to the following:

- references provided by previous employers, including any relevant complaint of fraud or misconduct against the individual;
- if the individual has been subject to disciplinary action by its previous employer or to any adverse finding or settlement in civil proceedings;
- whether the individual has been refused the right to carry on a trade, business or profession requiring a licence, registration or other professional designation;
- in light of the individual's responsibility, whether the individual's reputation may have an adverse impact on the firm for which the activity is to be performed.

Section 31 – Responsibilities of senior derivatives managers

Under paragraph 31(1)(b), an appropriate response to material non-compliance is a contextual determination, depending on the harm or potential harm, of the non-compliance. We are of the view that an appropriate response could include one or more of the following, depending on the circumstances:

- rectifying the non-compliance;
- disciplining one or more individuals who perform an activity on behalf of the derivatives firm relating to transacting in, or providing advice in relation to, a derivative;
- improving (or recommending improvements to) processes, policies and procedures aimed at ensuring compliance with the Instrument, applicable securities legislation and the policies and procedures required under section 30 [*Policies, procedures and designation*].

An appropriate response could include directing a subordinate to respond to the non-compliance.

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

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Subsection 31(2) – Senior derivatives manager's report

We consider non-compliance with the Instrument or applicable securities legislation to be material if the non-compliance creates a risk of material harm to a derivatives party or to capital markets or otherwise reflects a significant pattern of non-compliance. Whether the harm is "material" is dependent on the specific circumstances. For example, material harm to a small, unsophisticated derivatives party may differ from the material harm to a large, more sophisticated derivatives party.

We would expect that in complying with the requirement to submit a report under paragraph 31(3)(a) that reasonable care will be exercised 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 of the misconduct.

Section 32 – Responsibility of a derivatives firm to report material non-compliance

The requirement on a derivatives firm to make a report to the securities regulatory authority under section 32 will depend on whether the particular non-compliance would reasonably be considered by the derivatives firm to be material non-compliance with the Instrument or applicable securities legislation and create a risk of material harm to a derivatives party or to capital markets or otherwise reflect a significant pattern of non-compliance.

The derivatives firm should establish a standard for determining when there is a risk of material harm to a derivatives party of the firm or to the capital markets. Whether the harm is "material" is dependent on the specific circumstances. Material harm to a small, unsophisticated derivatives party may differ from the material harm to a large, more sophisticated derivatives party.

For registered derivatives firms, the expectation is that the report to the regulator could be provided by the derivatives chief compliance officer or the derivatives ultimate designated person. The term "ultimate designated person" means,

(a) the chief executive officer of the derivatives firm, or if the derivatives firm does not have a chief executive officer, an individual acting in a capacity similar to that of a chief executive officer;

(b) a partner or the sole proprietor of the registered derivatives firm;

(c) if the registered derivatives firm has other significant business activities, the officer in charge of the division of the derivatives firm that acts as a derivatives dealer or as a derivatives adviser.

DIVISION 2 – RECORDKEEPING

Subsection 33(2) – Derivatives party agreement must establish all material terms

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

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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 include terms that cover margin requirements, assets that are acceptable as collateral, collateral valuation methods, investment and rehypothecation of collateral, and custodial arrangements for initial margin, if applicable.

Section 34 – Records

Section 34 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 sets out the minimum records that must be kept. 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.

The principle underlying section 34 is that a derivatives firm must document, through its records,

- compliance with all applicable securities legislation (including the Instrument) for its derivatives-related activities,
- the details and evidence of each derivative 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-transaction 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 they are 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 the conditions of the exemption or exclusion are met.

With respect to records required under paragraph 34(b), demonstrating the existence and nature of the derivatives firm's derivatives, and records required under paragraph 34(c) documenting the transactions relating to the derivatives, we expect a derivatives firm to accurately and fully document every transaction it enters into and to keep records to the extent that they demonstrate the existence and nature of the derivative. 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

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the derivatives firm. These records of communications kept by a derivatives firm may include notes of 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 35 – Form, accessibility and retention of records

Paragraph 35(1)(a) 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.

PART 6
EXEMPTIONS

The Instrument provides several exemptions from the requirements in the Instrument. If a firm is exempt from a requirement in the Instrument, the individuals acting on its behalf are likewise exempt.

DIVISION 1 – EXEMPTION FROM THIS INSTRUMENT

Section 37 – Exemption for certain derivatives end-users

Section 37 provides an exemption from the application of the Instrument for a person or company that does engage in the activities described in section 37 and not have the status described in section 36.

For example, a person or company that frequently and regularly transacts in derivatives to hedge business risk but that does not undertake any of the activities in paragraphs (a) to (e) of subsection (1) may qualify for this exemption. Typically, such a person or company would transact with a derivatives dealer who itself may be subject to some or all of the requirements of the Instrument.

DIVISION 2 – EXEMPTIONS FROM SPECIFIC REQUIREMENTS IN THIS INSTRUMENT

Section 38 – Foreign derivatives dealers

General principle

Section 38 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

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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. If a foreign derivatives dealer is not subject to the requirements in a foreign jurisdiction listed in Appendix A, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 38 will not be available. If the foreign derivatives dealer relies on an exclusion or exemption in the foreign jurisdiction, it would need to apply to the relevant securities regulatory authorities for consideration of similar exemptive or discretionary relief from the Instrument

Conditions

This exemption in section 38 is available if the foreign derivative dealer is dealing only with persons or companies that are eligible derivatives parties. The foreign derivatives dealer must comply with each of the conditions set out in subsections (2), (3) and (4). Furthermore, there may be “residual” provisions of the Instrument listed in Appendix A which must be complied with even if the foreign derivatives dealer is in compliance with the laws of a foreign jurisdiction set out in Appendix A.

The disclosures contemplated in paragraph 38(3)(b) can be made by a derivatives firm in a master trading agreement with its derivatives party.

Section 41 – Derivatives traded on a derivatives trading facility that are cleared

Where a derivatives firm enters into a transaction with a derivatives party on an anonymous derivatives trading facility or an analogous platform (e.g., a swap execution facility), it may not be possible for the derivatives firm to establish the identity of the derivatives party prior to entering into the transaction. We understand that a trading platform would perform know-your-derivatives party diligence prior to accepting a derivatives party for trading on the platform; accordingly, this section of the Instrument includes an exemption for the derivatives firm in these circumstances.

We do not expect that derivatives trading facilities rules will permit non-eligible derivatives parties to transact anonymously on a derivatives trading facility.

DIVISION 3 – EXEMPTIONS FOR DERIVATIVES ADVISERS

Section 42 – Advising generally

Section 42 contains an exemption from the requirements applicable to a derivatives adviser if advice is not tailored to the needs of the recipient.

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In general, we would not consider advice to be tailored to the needs of the recipient if it

- is a general discussion of the merits and risks of a derivative or class of derivatives,
- is delivered through newsletters, articles in general circulation newspapers or magazines, websites, e-mail, internet chat rooms, bulletin boards, television or radio, and
- does not claim to be tailored to the needs and circumstances of any recipient.

This type of general advice can also be given at conferences. However, if a purpose of the conference is to solicit the audience and generate specific transactions in specific derivatives or class of derivatives, we may consider the advice to be tailored or we may consider the individual or firm giving the advice to be engaged in trading activity.

Under subsection 42(3), if an individual or a firm relying on the exemption has a financial or other interest in the derivative or class of derivatives it recommends, or in an underlying interest of the derivative, it must disclose the interest to the recipient when it makes the recommendation.

Section 43 – Foreign derivatives advisers

General principle

Section 43 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. If a foreign derivatives adviser is not subject to the requirements in a foreign jurisdiction listed in Appendix D, including where it relies on an exclusion or an exemption (including discretionary relief) from those requirements in the foreign jurisdiction, the exemption in section 43 will not be available. If the foreign derivatives adviser relies on an exclusion or exemption in the foreign jurisdiction, 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 if the foreign derivative adviser is advising persons or companies that are eligible derivatives parties. The foreign derivatives adviser must also comply with each of the conditions set out in subsections (2), (3) and (4). 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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The disclosures contemplated in paragraph 43(3)(b) can be made by a derivatives firm in account opening documentation.

PART 8
EFFECTIVE DATE

Section 45 – Effective Date

This Instrument comes into force on [●] and therefore any transaction entered into by a derivatives firm from this date forward is subject to the terms of the Instrument, except only section 8 [*Fair dealing*], section 20 [*Daily reporting*] and section 28 [*Derivatives party statements*] will apply to pre-existing transactions if the following conditions are met:

- the transaction was entered into before the in-force date; and

- the derivatives firm has taken reasonable steps to determine that its derivatives party is either (i) a “permitted client” under NI 31-103, (ii) an “accredited counterparty” under the *Derivatives Act* (Quebec), or (iii) a “qualified party” as that term is defined the relevant blanket orders in the provinces of Alberta, British Columbia, Manitoba, New Brunswick or Nova Scotia.

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ANNEX IV

Alternative version of the definition of "affiliated entity"

In this Instrument, a person or company (the first party) is an affiliated entity of another person or company (the second party) if any of the following apply:

(a) the first party and the second party are consolidated in consolidated financial statements prepared in accordance with

(i) IFRS, or

(ii) generally accepted accounting principles in the United States of America;

(b) all of the following apply:

(i) neither the first party's nor the second party's financial statements, nor the financial statements of another person or company, were prepared in accordance with the principles or standards specified in subparagraphs (a)(i) or (ii);

(ii) the first party and the second party would have been, at the relevant time, required to be consolidated in consolidated financial statements prepared by the first party, the second party or the other person or company, if the consolidated financial statements were prepared in accordance with the principles or standards specified in subparagraphs (a)(i) or (ii);

(c) both parties are prudentially regulated entities that are supervised on a consolidated basis.

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ANNEX V

LOCAL MATTERS

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

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Capital Power

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September 11, 2018

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 Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Me Anne-Marie Beaudoin
Corporate Secretary
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Grace Knakowski
Secretary
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Dear Sirs/Mesdames:

RE: Comments on Proposed National Instruments 93-101 *Derivatives: Business Conduct* and its proposed companion policy (the "Proposed Business Conduct Instrument"), and 93-102 *Derivatives: Registration* and its proposed companion policy (the "Proposed Registration Instrument", and collectively with the Proposed Business Conduct Instrument, the "Proposed Instruments")

Capital Power Corporation, together with its affiliates and subsidiaries (collectively, "**Capital Power**"), makes this submission in response to the Canadian Securities Administrators' April 19, 2018 request for comments on the Proposed Registration Instrument and June 14, 2018 second request for comments on the Proposed Business Conduct Instrument. Capital Power appreciates the opportunity to comment on

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and commends the Canadian Securities Administrators ("**CSA**") not only for seeking public input on the Proposed Instruments but also for aligning the comment periods for the Proposed Instruments. Capital Power believes that the subject matter of the Proposed Instruments is so closely inter-related and inter-dependent that it is logical to develop them and move them forward together.

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 participated in drafting the IECA's comment letter to the Proposed Instruments. As such, Capital Power supports and recommends all of the IECA's comments with respect to the Proposed Instruments.

Capital Power is also aware of the comments submitted by Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, in a letter dated August 2, 2018 (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 Proposed Registration Instrument set forth in the Sutherland Letter.

COMMENTS:

In addition to supporting the comments in the IECA's letter and the Sutherland Letter, Capital Power has the following specific and general comments regarding the Proposed Instruments:

Specific Comments:

1. Definition of "affiliated entity" (CSA Question 2 in Proprosed Registration Instrument).

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In the Proposed Registration Instrument the CSA has defined "affiliated entity" on the basis of "control" and has set out certain tests for control. Additionally, the CSA has proposed an alternative definition of "affiliated entity", in Annex II of the Proposed Registration Instrument, based on the accounting concept of "consolidation". The CSA has asked for comments with respect to these two proposed definitions and Capital Power offers the comments below.

Capital Power believes that the definition of "affiliated entity" based on "control" is the preferable definition not only for both Proposed Instruments but also across all present and future instruments that the CSA may implement with respect to derivatives regulation. We prefer a control based definition of affiliation because that approach is consistent with definitions of affiliation found in business corporations' statutes across Canada and is therefore a concept with which businesses are familiar.

Capital Power believes that clarity and consistency among statutes, regulations and regulatory instruments, such as the Proposed Instruments, fosters compliance because it lessens the complexity and therefore the business costs and efforts required for compliance. For these reasons, Capital Power submits that the Proposed Instruments should be as consistent with other existing legal concepts as much as possible, unless deviation is warranted and justified for specific purposes. Capital Power does not believe that such deviation is warranted or justified within the Proposed Instruments for the "affiliated entity" definition, given that the legal concept of affiliation is already well and consistently established under Canadian business corporations' law.

General Comments:

1. Transition/implementation periods and effective dates for the Proposed Instruments.

Capital Power notes that the proposed transition/implementation period in Section 12 and the proposed effective date in Section 13 of the Proposed Registration Instrument are currently blank. Also, the italicized language in Section 45(1) of the Proposed Business Conduct Instrument suggests that it will become effective one year after the date of final publication. Capital Power supports the principle that each Proposed Instrument should have at least a one year implementation period, after date of final publication, before becoming effective.

Capital Power believes that a transition/implementation period of at least one year is reasonable and necessary given the complex and heavy compliance burden that will be placed on derivatives market participants who may be deemed to be derivatives dealers and therefore subject to both Proposed Instruments. Unless market participants are already registered as securities and/or swap dealers (or similar designations) under other Canadian or foreign laws, the compliance efforts required under the Proposed Instruments will be entirely new to most derivatives market participants.

Capital Power submits that most North American energy commodity derivatives market participants are not already registered dealers of any sort. Accordingly, any such market participants that become required to register as a result of the Proposed Instruments will not already have the required technological and human resources, and internal and external business processes, in place to comply with the Proposed Instruments. Putting those resources and process in place will take considerable time, effort and capital. Capital Power believes that a one-year transition/implementation period for the Proposed Instruments will allow newly deemed dealers the time necessary to ensure that they can be compliant with the Proposed Instruments.

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2. Scaling-back dealing activity and avoiding registration.

According to the CSA's guidance, in the companion policies to both Proposed Instruments, a party should determine whether or not it is a derivatives dealer based on a "holistic analysis" considering, among other things, a list of "factors in determining a business purpose" (i.e. the "registration or business triggers"), discussed at length at pgs. 92-96 of the Proposed Registration Instrument companion policy and pgs. 100-103 of the Proposed Business Conduct Instrument companion policy. Both the IECA's comment letter and the Sutherland Letter address various aspects of the registration or business triggers and the need for further clarification concerning them.

In addition to supporting the call for further clarification, Capital Power submits that if an entity has conducted a holistic analysis of its derivatives-related activities and concluded that it is a derivatives dealer under the Proposed Instruments, and the level of its dealing activities exceeds any applicable de minimis threshold, such entity should not have to register as a dealer unless it materially (e.g. more than 20% over) exceeds the threshold for at least 3 consecutive months. Additionally, if the conditions in the preceding sentence are met, such entity should have the option of either: (i) having to register as a dealer within some reasonable time period (no earlier than 2 months) after having materially exceeded the threshold for such 3 month period; or (ii) scaling back its dealing activity such that it no longer materially exceeds the threshold in the following 3 consecutive month period.

Capital Power believes that this flexible approach to either requiring registration, or allowing dealers to reduce their dealing activities, would promote the regulatory goals of increased derivatives market oversight, risk mitigation, and robust investor protection, while at the same time avoid placing significant compliance burdens on market participants who may inadvertently exceed the de minimis dealing thresholds for limited periods of time and/or to an immaterial extent.

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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Canadian Market
Infrastructure Committee

Via e-mail to: consultation-en-cours@lautorite.gc.ca
comments@osc.gov.on.ca

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

September 12, 2018

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* Published June 14, 2018 ("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 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. 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.

Since 2010, CMIC has been providing commentary on proposed draft rules and consultation papers with respect to the regulation of the OTC derivatives market in Canada. CMIC's comment letters have consistently supported the harmonization of rules across Canada. Since the OTC derivatives

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[1] "Canadian public authorities" means representatives from Bank of Canada, Canadian Securities Administrators, Department of Finance and The Office of the Superintendent of Financial Institutions.

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market is a global market[2] with Canada representing only approximately 4% of that global market,[3] it is very important that our OTC derivatives rules are harmonized across Canada and also harmonized with regimes in larger markets outside Canada. It will otherwise become too costly for a foreign counterparty to enter into OTC derivatives transactions with a Canadian counterparty if it requires analysis and compliance with rules that are different across provinces and territories and inconsistent with global rules.

BACKGROUND – PREVIOUS RESPONSE LETTER

CMIC provided a detailed comment letter dated August 31, 2017 (our "**Initial Response**")[4] on the draft proposed National Instrument 93-101 published on April 4, 2017 (the "**Initial Draft of NI 93-101**"). CMIC members are very concerned that virtually none of its recommendations, and certainly none of its significant recommendations, in its Initial Response were accepted by the Canadian Securities Administrators ("**CSA**"). The second draft of NI 93-101 fails to take account of the very serious issues raised by CMIC and other commentators in the first round of public consultation. If implemented, this rule, particularly in combination with the draft registration rule published April 19, 2018 (the "**Registration Rule**" or "**NI 93-102**"),[5] would cause harm to the Canadian economy because the rules would significantly reduce liquidity in the Canadian OTC derivatives market both cross-border and domestically. These two draft rules fail to (i) present a Canadian regime that is harmonized with global regulatory initiatives and international standards, taking into account the smaller market size in Canada, (ii) recognize the difference between "securities" and "derivatives" markets; (iii) calibrate derivatives rules (as per IOSCO recommendations[6]) where equivalent prudential regulation is present; and (iv) recognize their disruptive impact on a well-functioning and well-regulated market. Furthermore, these failings are present notwithstanding that no justification for introducing a unique unharmonized Canadian regime is provided. In this letter, we will be referring to certain submissions made in our Initial Response which were not accepted, but on which we have further commentary and support.

EXECUTIVE SUMMARY

Our submissions in this letter are supported by these six principal themes:

1. Derivatives Market Liquidity: Ensuring that Canadian OTC derivatives market regulation does not significantly reduce liquidity is a critical objective. The broad extraterritorial effect of the Proposed Rules place Canadian counterparties at a significant disadvantage. Regulation that imposes unique requirements will deter market makers from continuing to participate in the Canadian OTC derivatives market. This deterrent effect will be felt by both foreign banks and domestic banks, especially in those Canadian jurisdictions where they currently have a modest presence. Maintaining a robust, competitive Canadian OTC derivatives market is important for systemic and economic purposes. A properly functioning modern economy requires businesses to be able to hedge risks to their businesses.

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[2] In other words, a large majority of transactions entered into by Canadian market participants will be with a non-Canadian counterparty.

[3] Total notional amount of global OTC derivatives contracts at the end of June 2016 was USD 544 trillion. See "Statistical release OTC derivatives statistics at end-June 2016", Bank for International Settlements, November 2016 at pg. 11, available here, converted to CAD 701.76 trillion using the June 30, 2016 exchange rate of 1.29 found here. The Canadian OTC derivatives market is estimated at CAD 30 trillion for Q2 2016. See "Toward More Resilient Markets: Over-the-Counter Derivatives Reform in Canada", Bank of Canada Financial System Review, December 2016 at page 54, available here.

[4] Available here.

[5] See our letter on NI 93-101 dated September 12, 2018, submitted concurrently with this letter.

[6] International Organization of Securities Commissions ("**IOSCO**"), "International Standards for Derivatives Market Intermediary Regulation, Final Report", June 2012, available here ("**DMI Report**").

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2. Incomplete Rules: It is impossible to properly analyze the Proposed Rules without completed appendices. Without completed appendices, the impact of the Proposed Rules cannot be understood. CMIC urges the CSA to conduct a third consultation on the Proposed Rules in its entirety once the appendices have been populated.

3. Balanced Derivatives Market Regulation: Proper derivatives market regulation must balance the costs and benefits of regulation, with the balance tipping in favour of further regulation only when there is an apparent problem that is not otherwise addressed by existing regulation. No such cost-benefit analysis has been conducted or problem identified. IOSCO has expressly recommended that regulation should not be adopted where prudential (or other) regulation already addresses any identified risk. Since Canadian prudential regulation covers these risks, further regulation is not necessary. Such an approach would be consistent with IOSCO recommendations.

4. OTC Derivatives Market vs Securities Market: There are fundamental differences between the securities market and the OTC derivatives market that are ignored by the Proposed Rules. We recommend that certain rules be amended or deleted in order to reflect these fundamental differences.

5. Harmonization: The Canadian OTC derivatives market is a part of a global market that relies heavily on global participation. Due to the relatively small size of the Canadian OTC derivatives market, many foreign dealers and advisers will not assume increased legal and regulatory risk and compliance burden associated with unique Canadian rules, which will result in a significant reduction in liquidity. Accordingly, we recommend that NI 93-101 be harmonized with global approaches and international standards, taking into account the smaller market size in Canada, particularly with the Commodity Futures Trading Commission's ("**CFTC**") rules[7] under Dodd-Frank[8] and certain portions of the definition thereunder of the term, "eligible contract participant".

6. Timing of Implementation: Given the proposed review and re-assessment of the CFTC rules and the fact that the Securities and Exchange Commission's ("**SEC**") 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:

- Substituted Compliance: We recommend that, on an outcomes basis, foreign derivatives dealers that are registered as swap dealers under CFTC rules, investment firms that are subject to the requirements of MiFID II and Canadian financial institutions that are subject to OSFI supervision should be exempt from all the requirements under NI 93-101. If the CSA does not accept this recommendation, substituted compliance should be applicable for almost all of the provisions of NI 93-101, including the senior manager provisions, as outlined in detail in Schedule A and Schedule B of our Initial Response.

- Inter-dealer Exclusion: We strongly recommend and reiterate that the inter-dealer market be excluded from the Proposed Rules.

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[7] 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.

[8] *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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- FX Transactions: 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.

- Eligible Derivatives Party: We recommend that the definition of "eligible derivatives party" be revised to:

  - remove the financial threshold for commercial hedgers in paragraph (n);
  - lower the financial threshold in paragraph (m) for a non-individual from net assets of $25 million to total assets of $10 million; and
  - remove the knowledge and experience requirement under paragraphs (m), (n) and (o).

- Exemption for Unknown Counterparties: We recommend that the exemption in Section 41 of NI 93-101 should not be conditional on the derivatives party being an EDP and the exemption should be expanded to (i) cover all trades with unknown counterparties (whether or not cleared), (ii) apply in respect of section 9 (Conflicts of interest), section 11 (Derivatives-party-specific needs and objectives), section 12 (Suitability), section 18 (Relationship disclosure information) and section 19 (Pre-transaction disclosure).

This letter will begin by setting out several general comments that elaborate on the six principal themes above. This is followed by our additional comments on other provisions of NI 93-101. Our responses to specific questions raised by the regulators in the Notice accompanying NI 93-101 are set out in Schedule A to this letter.

GENERAL COMMENTS

Derivatives Market Liquidity: As the CSA will have seen from the trade reporting data, the Canadian derivatives market is only a very small part of the global derivatives market, and more than 80% of the Canadian market involves foreign banks. These characteristics mean that preserving foreign liquidity is essential for Canadian businesses to be able to hedge the risks associated with their operations. Introducing unique regulatory requirements will significantly reduce liquidity because the added regulatory burden will dissuade foreign banks from maintaining existing Canadian operations or existing Canadian coverage across Canada. One key reason why the Proposed Rules, in their current form, will significantly reduce liquidity is their extraterritorial scope. As discussed in more detail on page 8 (Extraterritorial Scope), having the Proposed Rules apply to transactions entered into between two counterparties who are trading from non-Canadian locations will place Canadian counterparties at a significant disadvantage. If a foreign dealer located in, for example, Europe, is required to comply with Canadian business conduct rules when facing the UK branch of a Canadian bank, it will choose instead to trade with a non-Canadian counterparty. While CMIC recognizes that, as eligible derivatives parties, trades between dealers will be subject to a reduced set of business conduct obligations, foreign dealers will nevertheless have to be comfortable that their business conduct towards Canadian dealers comply with fair dealing and conflict of interest requirements. To do so, foreign dealers would have to retain Canadian legal counsel and accept the attendant legal and regulatory compliance risks. Additionally, such foreign dealers will also be required to implement the Canadian senior derivatives manager regime which contains a number of serious problems, such as reporting to boards of directors. Imposing a customized corporate governance structure on foreign dealers in order to trade with Canadian dealers is not tenable.

As discussed below, in its Initial Response Letter, CMIC proposed the granting of an Inter-dealer Exclusion to ensure that the Canadian OTC derivatives market remains liquid. The CSA rejected this approach indicating that, "It is inappropriate and inconsistent with the rule to provide an outright

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exemption for the inter-dealer market and also inconsistent with the approach taken internationally”.[9] CMIC notes that, based on one of its member’s inquiries to external Asia-Pacific counsel, it is our understanding that:

- In Hong Kong and Singapore, there are no business conduct rules specifically for OTC derivatives for the inter-dealer market that are similar to the business conduct rules under the Dodd-Frank regime. Know your client, disclosure and suitability obligations will apply in respect of OTC derivatives in the future, but counsel advises that the inter-dealer market will be exempt.

- In Australia, which has a market that is comparable in size to the Canadian OTC derivatives market, there are no business conduct rules specifically for OTC derivatives for the inter-dealer market that are similar to the Dodd-Frank regime, nor is counsel aware of any plans to create such rules. There are some business conduct obligations in the Australian Corporations Act 2001 which apply generally to the provision of financial services, with some obligations limited to retail clients. Licensees also have general obligations relating to honest conduct. These appear to be more principles-based, in line with OSFI guidance.

Therefore, there are precedents in other comparable jurisdictions for an Inter-dealer Exclusion with respect to the business conduct rule.

Finally, materially reducing liquidity will create material systemic risk and have economic consequences that are harmful and unnecessary. The proposed business conduct rule, especially when combined with the proposed registration rule, risks serious and dangerous curtailment in domestic and cross-border liquidity and access in the Canadian derivatives market.

Incomplete Appendices: Without knowing how the appendices will be completed, it is impossible to properly analyze the Proposed Rules. Foreign dealers, foreign advisers, Canadian financial institutions and IIROC dealer members do not know whether they will be exempt from any of the requirements under the Proposed Rules. Accordingly, certain comments provided will become more or less important to a market participant, depending on how the appendices are completed. Completing the appendices to the Proposed Rules will constitute a material change to the rule and accordingly the entire rule will then need to be re-published for another 60 day comment period[10] so that market participants can properly analyze the effects of the proposed derivatives business conduct regime.

Balanced Derivatives Market Regulation: It is essential that derivatives regulation be balanced. Introducing unique Canadian derivatives regulation should only occur where existing regulation fails to address an apparent problem. Duplicative regulation is unnecessary regulation. IOSCO recommendations[11] clearly recognize the need to take account of existing and efficiently operating prudential regulation in formulating the scope and content of derivatives regulation. A good example of such a balanced approach is seen in the extensive substituted compliance provided by the CFTC to Canadian banks with respect to various central features of Dodd-Frank on the explicit basis of federal Canadian prudential regulation and guidance. The proposed business conduct rule, especially when combined with the proposed registration rule, fails to meet this test of balanced

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[9] See page 4825 of NI 93-101.

[10] See, for example, *Rule Making Procedure Regulation*, BC Reg 195/97. Available here.

[11] DMI Report, *supra* note 6.

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regulation by not identifying material gaps in existing regulation and by not taking into account well-functioning existing prudential (or other) regulation.

OTC Derivatives Market vs Securities Market: As we noted in our Initial Response, some of the provisions in NI 93-101 do not take into account the fundamental differences between the OTC derivatives market and the securities market.

An OTC derivatives transaction is a bilateral, privately negotiated transaction where two parties are acting as principal and, generally speaking, both parties create credit exposure to each other during the term of the transaction which compels good practices. The provision and management of credit is a core function and mandate of banks exercising their responsibility to promote economic growth. By extension, OTC derivatives are core to the business of banking. As such, the infrastructure and control framework governing OTC derivatives is extremely robust and proven, and there is unique statutory treatment given to OTC derivatives as “eligible financial contracts” under insolvency law. The participants in this market are institutional and the business is not retail oriented.

Contrast the above with a securities transaction where one party offers an investment to a potential investor, the sale of which is effected by an intermediary that acts as both a principal and an agent. The investor in a securities transaction does not have any further obligations to the issuer of the security. There is a high degree of individual and retail client participation in the 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 the OTC derivatives market, 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 market. As a result of these fundamental differences between the two markets, several concepts in the Proposed Rules which were derived from NI 31-103 are not applicable and are inappropriate to include in the Proposed Rules. For example, as discussed in greater detail below on pages 17 and 22, two of such provisions are the Fair Terms and Pricing and the Tied Selling provisions, respectively.

CMIC strongly recommends and reiterates that a three-tier structure is more appropriate than a two-tier structure and accordingly, all business conduct rules should not apply whenever dealers are transacting with each other. Please see our discussion below under Inter-Dealer Exclusion on page 10. This three-tier structure should be a significant step towards the recognition of the differences that exist between the OTC derivatives market and the securities market.

Harmonization: Another fundamental difference between the OTC derivatives market and the securities market is that the OTC derivatives market is global in nature. As mentioned above, more than 60% of OTC derivatives transactions that are entered into by Canadian bank members of CMIC involve non-Canadian counterparties. 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 market is very dependent on global participants. This highlights the importance of having Canadian rules harmonized as much as possible with global rules, taking into account the smaller market size in Canada. Adding unique Canadian rules is the opposite of harmonization. It has been the experience of CMIC members that certain foreign market participants do not find that the benefit of changing and expanding their policies, procedures and 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 who are swap dealers have been complying with for a number of years, is extremely important in order to have a

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level playing field among market participants regardless of jurisdiction. Any variation from the CFTC business conduct rules that is not calibrated to the smaller and more vulnerable Canadian OTC derivatives market will disproportionately increase implementation and compliance costs for global market participants. This is likely to result in global counterparties exiting the Canadian market, thereby materially reducing liquidity and access, and increasing systemic risk.

We note that the Proposed Rules could apply to a person or company that meets the definition of “derivatives adviser” or “derivatives dealer”, regardless of whether it is registered or exempted or excluded from the requirement to be registered in a jurisdiction. This approach is unharmonized with CFTC rules as well as rules in comparable jurisdictions, such as Australia. Moreover, this approach is unharmonized with domestic securities laws. Having the Proposed Rules apply to a person or company regardless of whether that person is required to be registered will only create market uncertainty and confusion. Further this approach could result in two different principal regulators, only adding to the confusion. In order to be harmonized both globally and domestically, the Proposed Rules should only apply to a person or company that is required to be registered under the Registration Rule as a “derivatives dealer” or a “derivatives adviser”.

Timing of Implementation: As we noted in our Initial Response, NI 93-101 should not become effective until the CFTC has assessed and acted on public comments received in connection with its project to simplify and modernize its rules, including its business conduct rules, and making them less costly to comply with. It is imperative that the final version of NI 93-101 does not go beyond what is required under the revised CFTC business conduct rule once these CFTC recommendations have been adopted. For example, on August 21, 2018 the CFTC announced that it had simplified and alleviated certain chief compliance officer obligations and annual compliance reporting requirements for futures commission merchants, swap dealers and major swap participants.[12] In addition, CFTC Chairman Giancarlo has acknowledged that the CFTC’s current approach to applying its swap rules to cross-border activities has resulted in a number of problems, causing fragmentation of global markets.[13] The relatively smaller and more vulnerable Canadian OTC derivatives market cannot withstand that kind of fragmentation and therefore the CSA should wait to see what the new CFTC approach will be. Further, the SEC’s business conduct rules for securities based swaps are not yet in force. As NI 93-101 will also govern securities-based swaps, the Canadian regime would have 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. Harmonization of NI 93-101 to US rules, taking into account the smaller market size in Canada, is critically important, and we recommend delaying the implementation of NI 93-101 until the later of the date on which the complete revised CFTC business conduct rules are in force and the date on which the SEC`s business conduct rules are in force.

SUBSTITUTED COMPLIANCE

As mentioned in our Initial Response, if the CSA used an outcomes-based approach in determining substituted compliance taking into account the entirety of the CFTC and MiFID II rules, as well as OSFI Guideline B-7 and other OSFI prudential rules, foreign derivatives dealers that are registered as swap dealers under CFTC rules, investment firms that are subject to the requirements of MiFID II and Canadian financial institutions that are subject to OSFI supervision would be exempt from all the requirements under NI 93-101.

CMIC notes that the IOSCO DMI Report recognizes that, for some jurisdictions, banks fall under the primary authority of prudential regulators and that “[t]he form the [licensing] requirements take is less

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[12] Commodities Futures Trading Commission, “Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers and Major Swap Participants”, 83 FR 43510. Available here.
[13] See CFTC Chairman Giancarlo’s September 4, 2018 speech to the City of London. Available here.

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important than the outcome of them."[14] Further, substituted compliance extended to Canadian banks by the CFTC[15] recognizes the absence of the need to address the requirements set out in the IOSCO DMI Report because of the presence of prudential regulation by OSFI through extensive and effective regulations and guidance. Accordingly, IOSCO's recommendations recognize that appropriate prudential regulation in a particular jurisdiction can easily provide sufficient regulatory coverage. Existing OSFI regulations and guidance are effective and supply the basis to exempt Canadian financial institutions from the requirements under NI 93-101.

However, if the CSA does not accept this approach, we remind the CSA that we completed Appendix A of the Initial Draft of NI 93-101 for foreign derivatives dealers and Appendix C for Canadian federally regulated financial institutions ("**FRFIs**") showing which specific sections should be given substituted compliance.

Since Appendix A and Appendix C of NI 93-101 remain blank, CMIC reserves the right to provide further comment on the entirety of NI 93-101 once those appendices have been published for comment. It is CMIC's view that these appendices are an integral part of the rule and, accordingly, we would need to consider the completed appendices in conjunction with the remainder of the rule, including the companion policy.

Further, the exemption for foreign dealers under Section 38 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. Further, as discussed in greater detail in CMIC's response letter to the Registration Rule, imposing conditions on foreign dealers and advisers, such as complete and unfettered access to such foreign company's books and records is inappropriate and will materially and negatively affect liquidity in the Canadian OTC derivatives market. Substituted compliance without these types of conditions will encourage foreign dealers and advisers to maintain existing business in Canada, or enter the Canadian OTC derivatives market.

EXTRATERRITORIAL SCOPE

CMIC notes the clarifying commentary that has been added to the Companion Policy with respect to the determination of when a firm is a derivatives dealer or a derivatives adviser in a local jurisdiction. However, CMIC urges that further commentary should be added to clarify that a firm will be a derivatives dealer in a local jurisdiction only if its front office sales and trading personnel who are interacting with the counterparty are located in such local jurisdiction (or its counterparty is located in such local jurisdiction), and a non-dealer counterparty will be in a local jurisdiction if its head office or principal place of business is located in such local jurisdiction. To hold otherwise would significantly reduce liquidity for Canadian counterparties and place Canadian market participants at a significant disadvantage. We describe two scenarios below to demonstrate these two points.

With respect to how a broad application of the CSA's jurisdictional scope will significantly reduce liquidity for Canadian counterparties, if the Proposed Rules apply to foreign dealers when transacting with Canadian derivatives dealers who are acting from foreign locations, all things being equal, those foreign dealers will choose to trade with non-Canadian counterparties. Given the relatively small size of the Canadian OTC derivatives market, the costs and regulatory compliance burden of instituting new compliance procedures for the Proposed Rules will far outweigh any benefits or commercial opportunities of trading with Canadian counterparties. We note that even if the substituted compliance provisions under section 38 apply, this will not address this significant issue. In such circumstances, foreign dealers would still be subject to the requirements under section 38 of the

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[14] Supra, Note 11 at 13.

[15] Comparability Determination for Canada: Certain Entity Level Requirements, 78 FR 78839, December 27, 2013, available here.

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Proposed Rules which includes submitting to a Canadian jurisdiction, reporting to Canadian regulators "in a timely manner" circumstances of material non-compliance and providing Canadian regulators with unfettered access to its books and records for its global businesses, of which OTC derivatives may only be a portion (and certainly, OTC derivatives with Canadian counterparties would only be a very small fraction). Accordingly, expanding the CSA's jurisdiction in such a broad extraterritorial fashion will significantly reduce liquidity to Canadian market participants and be disruptive to the Canadian OTC derivatives market.

A broad assertion of the CSA's jurisdiction will place Canadian market participants at a significant disadvantage. Currently, Canadian banks transact OTC derivatives with private banking clients in foreign jurisdictions through foreign branches and are subject to, and comply with, local laws. For example, individual clients in Hong Kong and Singapore are subject to minimum thresholds of financial assets of SGD $2 million (roughly CAD 2 million) and HKD $8 million (roughly CAD 1.3 million). Local law also requires that clients have derivatives knowledge and that the bank perform suitability assessments by considering the client's risk profile, investment needs and relative product features. In addition, risk disclosures are provided to the clients. Local regulators are in the best position to determine the appropriate standards in the markets that they regulate. Based on information currently available to one CMIC Canadian bank member, it is estimated that approximately half of the individuals that trade with it through its private banking client division would likely not meet the proposed EDP threshold. However, that bank may not necessarily have information regarding financial assets that are not managed by it and therefore would need to perform a client outreach to determine whether clients are EDPs. As CMIC has noted in its Initial Response, obtaining responses from clients to an outreach request is very difficult, especially from non-Canadian clients as it relates to Canadian regulatory matters. In particular, it has been the experience of CMIC members that it has been especially problematic obtaining representations from private banking clients (indeed, any client) where other banks have not requested similar information. This will put Canadian banks at a competitive disadvantage in foreign markets, which is particularly concerning given the global nature of the OTC derivatives market. The Proposed Rules should not be applicable in circumstances where a derivatives dealer is transacting from a non-Canadian jurisdiction with a derivatives party located in a non-Canadian jurisdiction because, as it relates to the derivatives transaction or that derivatives party, there is no meaningful nexus to Canada. In such circumstances, the firm, and the individual acting on behalf of the firm, would need to comply with the local laws of the jurisdiction in which it and the derivatives party are located. There is no benefit to imposing Canadian rules, and the associated administrative burden of a client outreach, on derivatives parties in jurisdiction where local laws already provide sufficient protection. This approach has been endorsed by CFTC Chairman Giancarlo in his recent speech to the City of London. After acknowledging that the CFTC's current approach to applying its swap rules to cross-border activities has resulted in a number of problems, Chairman Giancarlo stated that swap reforms that address market structure and trading practices should be uniform within a single trading jurisdiction, not vary in any regulatory jurisdiction based on the nationality of the trading counterparty and should not create separate domestic and foreign trading liquidity pools within the same regulatory jurisdiction.[16]

As noted in our Initial Response, the Companion Policy should be amended to clarify 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 hedging its Canadian dollar exposure, such US swap dealer would not be a "derivatives dealer" in Canada. CMIC strongly recommends that this jurisdictional point be expressly clarified in the Companion Policy.

[16] Supra note 13.

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Finally, if a foreign dealer is subject to the requirements under the Proposed Rules, the obligations under the rule should apply to its dealings with Canadian counterparties only, and not to the business conduct of the foreign dealer's entire organization and all its trading activities.

INTER-DEALER EXCLUSION

As we noted in our Initial Response, CMIC is of the view that the two-tiered approach does not go far enough and it therefore recommends that an exemption from the application of NI 93-101 be given to all derivatives dealers when transacting with another derivatives dealer or with a clearing agency[17] (such exemption, the "**Inter-dealer Exclusion**"). To be clear, there should be no conditions attached to this exclusion – as long as a transaction involves two derivatives dealers, the Proposed Rules should not apply.

The need for an Inter-dealer Exclusion is clear. Firstly, the main purpose of the Proposed Rules is to help protect investors. However, all bank members of CMIC unanimously agree that they do not need the protections under the Proposed Rules when transacting with other dealers. Secondly, CMIC notes that the CSA, in its notice and request for comment,[18] has quoted from the IOSCO DMI Report[19] as support for why these business conduct rules are necessary. However, the DMI Report is primarily focused on market intermediaries facing clients, and not facing other market intermediaries in particular and accordingly, the standards which IOSCO promotes should apply only when facing non-market intermediaries. Similarly, after years of considering this issue, U.S. regulators are focusing their best interest standards on retail customers and not institutional customers as set out in the S.E.C.'s proposed rule.[20] Thirdly, without this Inter-dealer Exclusion, CMIC is concerned that foreign dealers, particularly those whose home jurisdiction does not appear on Appendices A and D, would be subject to the business conduct rules and would therefore need to increase required resources and assume increased legal and regulatory risk and compliance burden to continue trading with other dealers. While CMIC recognizes that the business conduct obligations proposed for foreign derivatives dealers may, in practice, be more limited in scope than those proposed for local market participants, each foreign derivatives dealer that wishes to enter or stay in the Canadian market place will need to understand such obligations and accept the consequential legal and regulatory liability. CMIC members' prior experience suggests that many foreign dealers will not undertake the exercise in the first place and, in the end, simply choose to exit (or not enter) the Canadian market because of a unique Canadian regulatory burden. CMIC members have already experienced foreign dealers unwilling to trade with them because these foreign dealers were unwilling to understand what trade reporting obligations, if any, it had under Canadian trade reporting rules and because they were concerned about potential obligations under the Proposed Rules and the Registration Rule. Such foreign dealers have the option to trade OTC derivatives with other global dealers in larger jurisdictions such as Europe and the U.S. It would therefore make commercial sense to invest the additional resources and accept legal and regulatory risks in understanding business conduct rules in such larger jurisdictions, but unfortunately, given the size of the Canadian OTC derivatives market, that would not be the case for Canada.

CMIC further notes that substituted compliance for foreign dealers is insufficient to address the above concerns, unless substituted compliance has the effect of exempting the foreign dealer from all requirements under NI 93-101, including, for example, the delivery of a completed Form 93-102F1 *Submission to Jurisdiction and Appointment to Agent for Service*. This is why CMIC is proposing an exclusion under such circumstances in respect of all requirements of NI 93-101, as opposed to relying on substituted compliance.

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[17] See further discussion of clearing agencies on page 17 of this letter.

[18] See page 4804 of NI 93-101.

[19] DMI Report, *supra* note 6.

[20] Regulation Best Interest, 83 FR 21574, May 9, 2018, available here.

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DIFFERENCES WITH FX MARKET

CMIC recommended in its Initial Response that any derivatives firm following the FX Code of Conduct[21] should be exempt from NI 93-101 in connection with any FX transaction, whether or not its counterparty is an EDP. CMIC made this recommendation based upon the fact that (i) 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, (ii) 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, (iii) it has been adopted by the industry and received endorsement from the Bank of Canada[22] and (iv) any regulatory deviation from the FX Code of Conduct would result in market fragmentation.

This is one example of completely duplicative regulation. Given the recent universal application of the FX Code of Conduct to all FX transactions, there is no regulatory need for creating specific requirements with respect to FX products. The IOSCO DMI Report provides that: "Although there are a wide range of products that comprise the OTC derivatives market, and each product has different risks (such as systemic risk or risk of market abuse) jurisdictions should consider whether there is a regulatory need for creating specific registration requirements for each type of derivative product."[23] Accordingly, it is entirely appropriate, and in alignment with IOSCO standards, to have different standards apply to FX transactions.

The CSA has responded that the FX Code of Conduct does not impose legal or regulatory obligations on market participants. However, CMIC proposes that FX transactions would be excluded from the scope of NI 93-101 only if a derivatives dealer was in compliance with the FX Code of Conduct, thus imposing a regulatory obligation if a derivatives dealer were to rely on such exclusion, which is, in effect, no different than the framework around substituted compliance. In addition, if this exclusion were adopted, this would address the concerns we have with respect to the requirement for a written agreement in respect of FX transactions, as discussed on page 21 of this letter.

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[21] *FX Global Code*, available at: http://www.globalfxc.org/docs/fx_global.pdf ("**FX Code of Conduct**"). 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 created this FX Code of Conduct, which is a single, global set of best practices principles that are right-sized for the FX market.

[22] 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 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.

[23] DMI Report, *supra* note 6 at page 14.

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RESPONSES TO QUESTIONS

1) Definition of "affiliated entity"

The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

Answer: See our response to Question 2 in the CMIC response letter to the Registration Rule.

2) Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Answer:

Harmonization with CFTC Rules

CMIC notes the inclusion of a commercial hedger category under paragraphs (n) and (q) of the definition of EDP, as well as the partial attempt to harmonize the EDP definition with the definition of "eligible contract participant" under CFTC rules by using a CAD 10 million threshold under paragraph (n) of the definition of EDP.[24] However, the threshold levels under paragraph (m), (n) and (o) of the definition of EDP are not harmonized with the thresholds for eligible contract participant. For non-individual counterparties, the definition of eligible contract participant uses total assets of USD 10 million for a non-individual counterparty, as opposed to net assets of CAD 25 million under paragraph (m) of the EDP definition. Many commercial hedgers would be penalized if their EDP status is determined based on net assets, as opposed to total assets since, for many of them, their "real" economic value is often comprised in large part of non-monetary assets.[25] For a non-individual counterparty that is a hedger, the eligible contract participant threshold is net worth of USD 1 million, as opposed to net assets of CAD 10 million under paragraph (n) of the EDP definition. CMIC is concerned that if these threshold levels are not aligned (subject to our further comments immediately below with respect to the commercial hedger category under paragraph (n)), or at least amended such that all eligible contract participants will be an EDP, many foreign derivatives dealers who only deal with eligible contract participants may determine that the additional time and resources required to identify whether a Canadian counterparty is an EDP will not be worth the benefit of trading with such counterparties. This could significantly reduce liquidity in the Canadian OTC derivatives market.

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[24] As noted on page 4821 of NI 93-101.

[25] For example, many commercial hedgers own assets which are carried at cost on their balance sheet, net of applicable depreciation, as opposed to current fair market value. Accordingly, net assets based on balance sheet values do not fairly represent their "true" economic value.

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Commercial Hedgers – Financial Threshold

With respect to the threshold level for the commercial hedger category in paragraph (n) of the EDP definition, even if it is harmonized with CFTC rules, it will still not be low enough to include all counterparties who are currently able to hedge their commercial obligations using OTC derivatives. In fact, based on best available data and without the benefit of a client outreach, at least one Canadian bank member of CMIC estimates that approximately 90% of their existing mid-market OTC derivatives client base will not qualify as an EDP under the current formulation. Another Canadian bank member of CMIC estimates that almost all of their mid-market FX clients will not qualify as an EDP under the current formulation of that definition. CMIC would like to stress that identifying a particular financial threshold is not a good proxy for sophistication as it relates to this hedger category. For example, a relatively new company with limited financial resources, but being run by experienced and educated personnel, does not mean that the company is not sophisticated. As well, many of these types of counterparties are special purpose vehicles, intentionally structured to minimize net assets. These types of counterparties should be considered sufficiently sophisticated to be EDPs without a specified financial threshold. For these types of counterparties, they may well no longer be able to find a dealer willing to trade with them if the decision is made by derivatives dealers to only deal with EDPs. If they are able to find a dealer willing to trade with them, it is certain that the materially increased cost of compliance for dealing with non-EDPs will be passed along to such non-EDPs. The result in either circumstance will likely be the same: a very large portion of hedgers will not be able to have the benefit of this key risk management tool.

The types of transactions which commercial hedgers enter into are foreign exchange forwards, swaps and options and in some instances, vanilla interest rate swaps (including cross-currency interest rate swaps) where the hedger is typically the fixed rate payer, as well as some vanilla commodities transactions (essentially energy and agricultural). With respect to foreign exchange forwards and options, the alternative to transacting with banks will be for current hedgers to use money service businesses instead which are not as highly rated as banks and are not subject to prudential regulation. In addition to disrupting access and significantly limiting liquidity in the Canadian OTC derivatives market, this will increase concentration risk and systemic risk. CMIC is concerned that the types of counterparties from whom the CSA is seeking to protect hedgers are the very ones with whom hedgers will need to transact if they no longer have access to OTC derivatives transactions with banks because they do not qualify as EDPs. As for interest rate swaps, the CSA will be aware from examining trade reporting data that banks are the only meaningful providers of interest rate swaps. A vast majority of parties that are currently hedging interest rate risk will no longer have access to interest rate swaps based upon the current definition of an EDP if the decision is made by derivatives dealers to only deal with EDPs. If dealers decide to deal with non-EDPs, the increased cost of compliance will result in prohibitively high transaction costs for these commercial hedgers. Therefore, the commercial hedger category of EDP should (i) not include a financial test, which is consistent with the current approach under paragraph 12 of the definition of “accredited counterparty” under the *Quebec Derivatives Act*, and paragraph 7 of the definition of “qualified party” under Blanket Order 91-501 (BC) *Over-the-Counter Derivatives* and Blanket Order 91-507 (AB) *Over-the-Counter Trades in Derivatives*.

Knowledge and Experience Requirement

With respect to the knowledge and experience requirement in clauses (m), (n) and (o) of the definition of EDP, the specific knowledge and experience of the counterparty should not be part of the EDP definition. Knowledge and experience are factors contributing to suitability which is a matter to be determined separately under section 12 of the Proposed Rules. 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 or the fact that the transaction is being entered into for hedging purposes. Having a bright line financial resources test is consistent with the approach taken in other circumstances, for example,

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with respect to whether a party is an "accredited investor" under NI 45-106[26] 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". In addition, we note that the definition of eligible contract participant under CFTC rules does not include a knowledge and experience test. As noted above, if the EDP definition is not harmonized with the eligible contract participant definition under CFTC rules, there could be a significant decline in liquidity in the Canadian OTC derivatives market.

We recognize that the CSA has indicated that this knowledge and experience test is consistent with the requirements that currently apply in Quebec under the Quebec Derivatives Act. However, we note that it only applies to the accredited counterparty definition under paragraph (7) and does not apply to the hedger branch of the definition under paragraph (12). The vast majority of counterparties that currently represent to their counterparties that they are an "accredited counterparty" are doing so based on paragraph (12) of that definition. We understand that the CSA is concerned that hedgers are in need of more protection and therefore a financial test of $10 million net assets has been incorporated. The experience of CMIC members is that those counterparties are not in need of additional protections, at least certainly not from large banks and broker dealers comprising CMIC's membership. The current "know your client" and suitability procedures undertaken by CMIC sell-side members already determine whether OTC derivatives counterparties are knowledgeable about the products they trade. As noted above, hedgers mainly transact in products that are very liquid (interest rate swaps and foreign exchange swaps, options and forwards), and in markets that are very deep, competitive and transparent. Pricing for these types of transactions is readily and easily available to hedgers from dealers in the market. Accordingly, CMIC recommends that the knowledge and experience requirement under paragraphs (m), (n) and (o) of the definition of eligible derivatives party be removed.

Concluding Remarks regarding EDP Definition

CMIC cannot over-emphasize the importance that all "eligible contract participants" under CFTC rules must satisfy the definition of an EDP. All the exemptions under the Proposed Rules and the Registration Rule are conditional upon the derivatives firm dealing with, or advising, EDPs. In CMIC's view, not having all eligible contract participants qualify as EDPs will significantly contribute to the material risk that foreign dealers will withdraw from the Canadian OTC derivatives market. In addition, with respect to the commercial hedger category under paragraph (n), Canadian banks will likely only wish to transact with and advise EDPs and, accordingly, if CMIC's recommendations are not accepted, there may be a significant number of counterparties who are currently able to hedge their risks with banks who will not be able to continue doing so if the Proposed Rules and the Registration Rule were to come into effect. Accordingly, CMIC urges the CSA to (i) harmonize the EDP thresholds under paragraphs (m) and (o) with the eligible contract participant thresholds under CFTC Rules, (ii) remove the financial threshold test for commercial hedgers under paragraph (n) and (iii) as discussed on page 19 of this letter, remove the waiver requirement for commercial hedgers under section 7(2) of the Proposed Rules. Implementing CMIC's recommendation is critical to the continued proper functioning of the Canadian OTC derivatives market.

3) Anonymous transactions executed on a derivatives trading facility

We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption?

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[26] 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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We are also considering whether a similar exemption should be available in other scenarios, including, for example:

(a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and

(b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency.

Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

Answer:

CMIC fully supports expanding this exemption under section 41 to transactions other than those traded on a derivatives trading facility ("**DTF**") that are cleared. Specifically, it is CMIC's view that this exemption should apply to any transaction entered into with a counterparty where the counterparty's identity is unknown ("**Unknown Counterparties**"), whether or not that transaction is cleared and whether or not the transaction is entered into on a DTF. For example, 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.

Further, the exemption under section 41, as currently drafted, provides that it is only available if, at the time of the transaction, the derivatives party to the transaction that is being submitted for clearing is an EDP. For transactions with Unknown Counterparties, since the derivatives dealer does not know the identity of its counterparty, it will not be able to determine whether the derivatives party is an EDP. Even though section 41, as currently drafted, only applies to transactions on a DTF, and it is likely that DTFs will only accept counterparties that qualify as an EDP, the onus should not be on the derivatives dealer to vet and ensure that is the case.

In addition, section 41 only covers an exemption from the requirements under section 10 (Know your derivatives party) and section 27 (Content and delivery of transaction information). CMIC recommends that this exemption be expanded to also cover the following sections: section 9 (Conflicts of interest), section 11 (Derivatives-party-specific needs and objectives), section 12 (Suitability), section 18 (Relationship disclosure information) and section 19 (Pre-transaction disclosure). As with the determination of whether the derivatives party is an EDP, because the identity of the counterparty is not known, the derivatives dealer is unable to make a determination and comply with those sections of the Proposed Rules. Further, whenever a derivatives dealer is transacting with an Unknown Counterparty, it is doing so through an agent and the agent should be responsible for complying with these sections since it has the relationship with the Unknown Counterparty.

4) Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

Answer:

The obligations under section 16 should not be expanded to all derivatives parties. In fact, it is CMIC's view that derivatives firms will be incentivized to manage (and indeed, do manage) complaints

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from all derivatives parties in an appropriate manner in order to preserve their relationships with such derivatives parties. It is likely that transactions with EDPs will be more frequent, and for larger amounts, further incentivizing derivatives firms to promptly respond to complaints. Adding yet another obligation under these rules for which derivatives firms need to build formal compliance procedures only adds a further unnecessary administrative burden to complying with these rules.

5) Derivatives Party Assets

We note that the requirements with respect to initial margin in sections 25 and 26 only apply to transactions with non-EDPs. Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.

Answer:

Derivatives Party Assets

The requirements under sections 25 and 26 of the Proposed Rules do not conform to current market practice and will be disruptive if implemented as currently drafted. Counterparties always have the right to request that initial margin be segregated, that is, physically held in a separate account, including in an account at a third party permitted depository. Such segregation comes at a cost and accordingly, the counterparty will be charged an additional fee or a higher spread for such an arrangement. Counterparties should have the right to decide whether or not they would like initial margin to be segregated and the conditions, if any, with respect to such segregation. We note that even the CFTC does not require that initial margin delivered by all counterparties be segregated, only those subject to specific margin rules for uncleared derivatives. In fact, Dodd-Frank initially required that swap dealers provide counterparties with the right to elect segregation and required swap dealers to provide a re-notification of this right to elect segregation annually, and obtain confirmation from the counterparty of both its receipt of the notification and its decision whether to elect segregation. However, the latest rules provide that counterparties be given this option only at the outset of a trading relationship.[27] While this additional administrative burden may be acceptable for the U.S. derivatives market, in CMIC's view, it will not be for the Canadian OTC derivatives market. Instead, sections 25 and 26 of the Proposed Rules should be amended to provide that only if requested by a counterparty, the derivatives firm would be required to segregate initial margin and invest initial margin as stipulated by the counterparty. There should not be a positive obligation on the derivatives firm to ask its counterparties about segregation of any margin delivered to the derivatives firm.

6) Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.

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[27] Segregation of Assets Held as Collateral in Uncleared Swap Transactions, 83 Fed. Reg. 36484 (July 30, 2018). Available here.

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Answer:

Naturally, CMIC believes that everyone should conduct business with integrity, however, it is inappropriate to include such a requirement under Section 30(1)(c)(iii) in this rule for three reasons: (i) first, it would be extremely difficult to design compliance procedures around this requirement; (ii) the CSA have already incorporated a requirement for derivatives firms, and individuals acting on behalf of derivatives firms, to act honestly and in good faith which, in CMIC's view, is a more objective and manageable standard; and (iii) similar to the reasons set out with respect to the applicability of complaint handling requirements for EDPs, individuals and derivatives firms are already incentivized to act with integrity in order to attract and maintain business and client relationships. Accordingly, it is CMIC's recommendation that the requirement set out in section 30(1)(c)(iii) be deleted as it is completely unnecessary and the scope and content of any such requirement is exceedingly uncertain.

ADDITIONAL COMMENTS

Information Given to Regulator

CMIC is very concerned that there are various rules under NI 93-101 which require a derivatives firm to provide information to a provincial regulator, or provide the provincial regulator with access to information relating to a derivatives firm. For example, Section 32 provides that the derivatives firm is required to report on a timely basis to the provincial regulator where the derivatives firm is not, or was not, in compliance with NI 93-101 or securities laws related to trading or advising derivatives. In addition, Section 40(b) requires a FRFI to notify the regulator of each instance of material non-compliance with a requirement or guidance to which it is subject. Information provided to the CSA by a FRFI under these sections could well include prescribed supervisory information (PSI) depending on the specific circumstances. For example, some of these record keeping provisions relate to the prudential aspect of record keeping (e.g. business and strategic planning; audit, compliance and risk management; minutes of meetings of Boards of Directors). The reason for the concern is that PSI is protected under federal law and FRFIs are prohibited from sharing such information with anyone, including provincial regulators. It would be an offence under federal law for a FRFI to do so.[28] FRFIs can only provide this information to OSFI and it is OSFI's decision as to what information may be shared with provincial regulators. This strict federal prohibition on disclosure of PSI is a long standing feature of federal law that is designed to allow federal prudential and systemic regulators to mitigate and manage systemic risk. Accordingly, NI 93-101 should be amended to expressly exclude FRFIs being obliged to disclose PSI to provincial regulators.

Fair Terms and Pricing:

CMIC supports the change to the Companion Policy to provide that the fair dealing obligation in section 8 will be interpreted in a similar manner to mean "fair and balanced communications", consistent with CFTC Rules under Dodd-Frank.[29] However, in CMIC's view, this standard should apply not only when derivatives firms are dealing with eligible derivatives parties, but when dealing with all parties.

With respect to the fair terms and pricing obligation as set out in section 19 of the Initial Draft of NI 93-101, we note that this has now been incorporated as part of the fair dealing obligation under section 8, as described in the Companion Policy. This means that this obligation will now apply to both EDPs and non-EDPs. This is problematic for the following reasons. As noted in our Initial Response, the introduction of an express statutory duty to transact under terms that are "fair" could give rise to

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[28] Supervisory Information (Banks) Regulations, SOR-2001-59 under *Bank Act* (Canada). There are equivalent regulations under federal legislation applicable to other types of FRFIs.

[29] See 17 CFR Part 23, s. 23.433.

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negative unintended consequences. The derivatives dealer/counterparty relationship is not a fiduciary relationship in the ordinary course and 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 had hoped it would be.

Certainly, as it relates to EDPs, there should not be an obligation to transact under “fair” terms. EDPs are sophisticated parties and accordingly, they should know what is fair. In fact, as we noted in our Initial Response, 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 a number of derivatives dealers.

The Companion Policy provides that it is expected that the derivatives firm provide a derivatives party with information about the implications of terminating a derivative prior to maturity, including potential exit costs. Further, it also provides that deliberately “selling” a derivative that is not suitable for a derivatives party would not be considered “fair” and a breach of the fair dealing obligation. These statements should only apply when facing non-EDPs and the Companion Policy should be amended to clarify that.

In addition, the Companion Policy provides the following:

> As part of the policies and procedures required under section 30, a derivatives firm is expected to be able to demonstrate that it has established and follows policies and procedures that are reasonably designed to achieve fair terms, in the context, for the derivatives firm’s derivatives parties and that these policies and procedures are reviewed regularly and amended as required.
>
> We interpret the fair dealing obligation to include determining prices for derivatives transacted with derivatives parties in a fair and equitable manner. We expect there to be a rational basis for a discrepancy in price where essentially the same derivative is transacted with different derivatives parties. Factors that indicate a rational basis could include the level of counterparty risk of a derivatives party, the derivatives party’s trading activity, or relationship pricing. Lack of sophistication, knowledge or understanding about a derivatives product should never be a factor in providing less advantageous pricing. Both the compensation component and the market value or price component of the derivative are relevant in determining whether the price for a derivatives party is fair. A derivatives firm’s policies and procedures under section 30 must address how both the price of the derivative as well as the reasonableness of compensation are determined. A derivatives party should be given an opportunity, at their option, to obtain independent advice before transacting in a derivative.
>
> Derivatives firms are expected to obtain information from each derivatives party to allow them to meet their fair dealing obligation.[30]

The pricing of a derivatives transaction depends upon a number of factors that are interrelated and therefore, it will be very difficult to establish tests to ensure a firm is in compliance with such requirement to ensure there is a “rational basis” for a discrepancy in price where a similar derivative is transacted with different derivatives parties. In terms of what it means for a transaction to be “fair”, these are privately negotiated, bilateral, unique transactions. There is no simple way to determine whether all the components of a trade are fair. 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. Simply stated, if the derivatives party does not

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[30] See page 4872 and 4873 of NI 93-101.

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like the price quoted by a derivatives dealer, it is free to ask other dealers in the market for a competitive quote. Even then, variations in prices quoted by different dealers could simply be a result of a dealer's internal costs, including liquidity costs, capital charges and related hedging costs, producing higher or lower pricing and may be affected by market volatility. In this context, it would not be the case that an "unfair" price is being quoted. Finally, it is very uncertain what type of information is necessary to be obtained before a party can meet a "fair" dealing obligation.

CMIC therefore strongly recommends that the fair pricing commentary be removed from the Proposed Rules completely. Given the nature of derivatives transactions, the term "fair" in the context of "fair price" should be interpreted to mean what is commercially reasonable.

Waiver by Specified Commercial Hedgers

With respect to specified commercial hedgers, CMIC notes that Section 7(2) of the Proposed Rules requires that a waiver must be obtained by a derivatives firm from a specified commercial hedger if such derivatives firm wishes to be exempt from the provisions of the Proposed Rules, other than those set out in Section 7(1)(a)-(d) as they relate to such specified commercial hedger. There is no policy reason provided as to why specified commercial hedgers would need to provide such a waiver. Such a waiver is not necessary given that specified commercial hedgers are sophisticated entities. Further, the administrative burden of obtaining waivers from these clients will be significant. As noted in our discussion of the definition of EDP on page 12, CMIC strongly believes that derivatives firms will only wish to deal with EDPs in order to rely on the exemption under Section 7(1) of the Proposed Rules. Accordingly, if a waiver is not obtained from a specified commercial hedger, their access to the OTC derivatives market will effectively be eliminated, even though they meet the definition of an "EDP". In addition, no other current derivatives rule in Canada dealing with the exemption of protections under securities or derivatives legislation requires such a waiver.[31] CMIC therefore urges the CSA to remove this waiver requirement and treat specified commercial hedgers the same as all other EDPs.

Senior Derivatives Manager Regime

As noted in our Initial Response, 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. However, it is still not clear to CMIC (i) why the proposed senior derivatives manager regime is considered necessary in Canada, (ii) why the OTC derivatives market is being singled out since it is our understanding that a similar regime does not exist for the securities market, or indeed, any other market in Canada, and (iii) why existing compliance regimes are not satisfactory. No reason for introducing this unique regime in Canada has been identified. No explanation for why existing, regulation is insufficient has been provided. It is increasingly difficult to find people to fill current compliance roles due to the additional risk and responsibilities associated with such roles. It will become even harder to staff these senior manager roles from the ever decreasing pool of talent. In CMIC's view, it would appear that the cost, (including the time and effort required to maintain such a regime, not to mention its negative effect on liquidity/access given the unique nature of this regime), is not worth any as yet unidentified benefits to be derived from implementation. Accordingly, CMIC continues to recommend removing this regime from the Proposed Rules.

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[31] 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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If the CSA is unwilling to remove the senior derivatives manager regime, that regime should apply only to a derivatives business unit of a derivatives firm that deals with, or advises, non-EDPs. Otherwise, CMIC is very concerned that including this senior derivatives manager regime as currently proposed will lead to a significant reduction of liquidity/access in the Canadian derivatives market given that the requirements go beyond the OTC derivatives requirements in other jurisdictions, for example, the requirement to report directly to state or local securities regulators.

While CMIC is concerned that other regulatory regimes will not have a similar senior derivatives manager regime, we have reviewed legislation applicable to CMIC's sell-side members and have determined that, on an outcomes basis, substituted compliance should be given to Canadian financial institutions and to foreign dealers registered as CFTC swap dealers. Our Initial Response outlined in great detail the current, robust, existing compliance regime applicable to Canadian financial institutions, which represents a comprehensive approach to compliance and accountability that is consistent with existing global financial institution regulation. In fact, Canadian financial institutions are internationally well regarded in this area.

With respect to foreign dealers registered as "swap dealers" under CFTC rules, substituted compliance should be given to them on an outcomes basis. The supervisory requirements under the CFTC rules[32] provide as follows:

> CFR Title 17 Section 23.602(a): Each swap dealer and major swap participant shall establish and maintain a system to supervise, and shall diligently supervise, all activities relating to its business performed by its partners, members, officers, employees, and agents (or persons occupying a similar status or performing a similar function). Such system shall be reasonably designed to achieve compliance with the requirements of the Commodity Exchange Act and Commission regulations.

Swap dealers under CFTC rules that are prudentially regulated may likely be required to comply with similar rules and accordingly substituted compliance would apply to them.

CMIC notes that the Companion Policy provides that, other than in a small derivatives firm, the CSA would not expect a senior derivatives manager to be the chief executive officer of the derivatives firm, or an individual registered under NI 93-102 (if applicable) as any of the derivatives ultimate designated person, derivatives chief compliance officer or derivatives chief risk officer of the derivatives firm. It is not clear why this could not be the case. It should be acceptable and appropriate for a derivatives firm to make its own assessment as to who should be a senior derivatives manager.

Suitability:

CMIC believes very strongly that it is inappropriate to impose fiduciary or fairness standards on the OTC derivatives market, and doing so will significantly reduce liquidity in the Canadian market. The OTC derivatives market is different than the securities market in that the derivatives dealer is acting in the capacity of a counterparty to a transaction, and not as a fiduciary, and accordingly, should not be required to assess the suitability of any transaction or trading strategy involving a derivative for its counterparty. Derivatives dealers routinely operate based on a standard of commercial reasonableness, and not an equitable fairness standard. If the Canadian business conduct rules impose this type of fairness standard, it is CMIC's view that U.S. and other foreign dealers would be unwilling to risk the potential legal consequences of participating in this market, resulting in decreased liquidity and customer access. CMIC notes that under the CFTC rules, a swap dealer will be deemed

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[32] CFR Title 17 Section 23.602(a).

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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.[33] A similar safe harbour should be included under the Proposed Rules and such a safe harbour is imperative in order to maintain liquidity in the Canadian OTC derivatives market.

In addition, CMIC believes that the scope of the suitability obligations in respect of individuals as contemplated under Section 12 is too wide, particularly insofar as these obligations appear to require any individual acting on behalf of a derivatives firm to take reasonable steps to assess suitability. In CMIC's view, if an individual acting on behalf of a derivatives firm is to have this obligation, only the trader should be responsible for assessing suitability. It would be unreasonable to impose such a suitability obligation on everyone in the derivatives firm who "touches" the transaction, for example, a back office person or in-house counsel. We note that under NI 31-103,[34] only registrants are required to assess suitability and, accordingly, a similar approach should be taken with respect to OTC derivatives.

Reporting to Derivatives Parties

With respect to the requirement for derivatives dealers to provide daily valuations, the Proposed Rules should allow counterparties to be given the option of not being provided with the daily valuation required under section 20(1) as certain counterparties may not be interested in receiving that information. In such circumstances, the derivatives firm should not be required to make that information available to those counterparties.

Record-keeping

It is current market practice for FX transactions to be entered into between parties without entering into a written ISDA (or similar) master agreement due to the fact that the FX markets are mature and transparent. CMIC notes that, notwithstanding this market practice, both the CFTC rules and section 33 of NI 93-101 require that parties enter into a written agreement before transacting in a derivative. In order to continue with market practice, under 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 ISDA Dodd-Frank 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 and the resulting difficulty of obtaining responses to a client outreach. 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 inconsistency and the disruption it would cause, 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 above, 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.

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[33] See 17 CFR Part 23, s. 23.434(b).

[34] National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

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Tied Selling

CMIC reiterates that the tied selling rules are duplicative of existing rules found in Canadian legislation. For example, there are provisions under the Bank Act[35] 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, the tied selling provisions should be deleted from the Proposed Rules.

Transition (permitted client/qualified party/accredited counterparty)

CMIC supports the inclusion of section 45(3) which allows derivatives dealers to rely on existing representations received in connection with pre-existing transactions. However, in CMIC's view, clarification is required in order to determine under what circumstances sections 20 and 28 will need to be complied with. Sections 20 and 28 are only applicable in the case of non-EDPs and individual EDPs and commercial hedgers who have not waived their protections under these two provisions. In CMIC's view, derivatives dealers should be able to assume that such waivers have been provided when relying upon the representations as set out in section 45(3)(b). This would mean that only section 8 would need to be complied with as it relates to such individual EDPs and commercial hedgers.

Effective Date

CMIC recommends that there be a transition period of at least three years, starting with the date the rules come into force. In addition, CMIC urges that the registration rule and the business conduct rule take effect concurrently. Where a client outreach initiative is required, in order to avoid regulatory fatigue, it is imperative that this be done only once. Accordingly, both rules should be finalized before the three year transition period commences. This would then give derivatives firms three years to prepare for both new business conduct requirements and for registration and all the related obligations, such as implementing appropriate policies and procedures, finding and training personnel, conducting any client outreach initiatives, obtaining representation letters and amending existing documentation where necessary.

CONCLUSION

As you will have seen, CMIC has provided its comments and recommendations on the Proposed Rules within the six themes of (i) derivatives market liquidity, (ii) incomplete rules, (iii) balanced derivatives market regulation, (iv) fundamental differences between the OTC derivatives market and the securities market (for example, Inter-dealer Exclusion, FX Transaction exemption, and fair terms and pricing recommendations), (v) harmonization with global rules, and (vi) the timing of implementation (effective date recommendation).

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[35] See the Bank Act, s. 459.1.

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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
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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Ref: GYG/70/H30
September 14, 2018

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Comments on the Proposed Instrument *Derivatives: Business Conduct* issued by the Canadian Securities Administrators

Dear Madams:

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the Proposed National Instrument 93-101 *Derivatives: Business Conduct* and the Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (collectively, "Proposed Instrument") issued on June 14, 2018 by the Canadian Securities Administrators ("CSA"). We respectfully expect that the following comments will contribute to your further discussion.

We would highly appreciate it if you read this comment letter and our comment letter concurrently submitted to the CSA in respect of Proposed National Instrument 93-102 and its companion policy issued in April together, given many issues are related to each other.

[General Comments]

1. Exemption based on equivalence assessment

From the perspectives of international comity and avoidance of excessive regulatory burdens, the CSA should flexibly grant an exemption to non-Canadian financial institutions that are complying with their national OTC derivatives regulations, such as Japanese banks, based on equivalence assessment without imposing on any conditions to

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qualify for the exemption. It would be appropriate to be regulated by home authorities, particularly with respect to compliance requirements on “derivatives business unit” for foreign derivatives dealers prescribed in Part 5 (Section 29-35).

(Rationale)

Japan has already implemented the OTC derivatives regulations following the G20 agreement by incorporating them into the Financial Instruments and Exchange Act (the “Act”) whose equivalence to U.S. regulations has been recognized by the CFTC. Imposing Canadian registration requirements on Japanese financial institutions that are already subject to such a strict national regulation would force them to address inefficient duplicated regulations, which lead to excessive regulatory burdens. Therefore, the CSA should carry out a comprehensive equivalence assessment on other jurisdiction’s legislation and exclude foreign financial institutions in such a jurisdiction from the scope of application of the Proposed Instrument if they are deemed as complying with strict national OTC derivatives regulations that are recognized as equivalent to the requirements in the Proposed Instrument.

When the OTC derivatives regulations under the Dodd-Frank Act took effect in the U.S., some financial institutions terminated their transactions with U.S. firms. Similarly, if financial institutions that are subject to national OTC derivatives regulations are required to comply with the requirements in the Proposed Instrument, some financial institutions may cease from transacting with Canadian firms in order to avoid regulatory burdens, causing adverse consequences on the liquidity of Canadian derivatives markets.

Even if the exemption based on equivalence assessment is not granted, it would be appropriate to be regulated by home authorities, with respect to requirements on “derivatives business unit” for foreign derivatives dealers prescribed in Part 5, including establishment of policies and procedures, establishment of compliance system and recordkeeping, in order to eliminate duplicated regulation.

The following comments are provided in case that the Japanese financial institutions are not granted an exemption from the requirements in the Proposed Instrument.

2. Clarification of the scope of application

We request the CSA to clarify the definition of “in Canada” used in the Proposed Instrument and consider how the requirements in the Proposed Instrument will apply to cross-border transactions. Specifically, the scope of application of the Proposed Instrument should be limited to transactions entered into within Canada by a dealer registered as a derivatives dealer with Canadian authorities. Furthermore, if transactions

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executed by a registered non-Canadian dealer are included in the scope of application, such transactions should be limited to trading with a non-eligible derivatives party ("non-EDP") in Canada.

(Rationale)

Given that the term "in Canada" is used in the preamble, etc. of the Proposed Instrument (p. 4804 "Substance and Purpose of the Proposed Instrument"), it is our understanding that the Proposed Instrument applies to derivatives transactions conducted in Canada. However, it is not necessarily clear in what cases cross-border transactions will be subject to the requirements in the Proposed Instrument specifically. In this view, the CSA should provide clarification to the definition that transactions "in Canada" subject to the requirements in the Proposed Instrument are limited to transactions conducted within Canada such as "transactions executed and booked within Canada," or "transactions with a Canadian counterparty located within Canada". If it is not clarified, the Proposed Instrument could be interpreted in a way that it will apply to all derivatives dealers and even to all of those transactions entered into between non-Canadian derivatives dealers. This will cause excessive regulatory burdens on financial institutions established in foreign jurisdictions. If it is determined to include transactions executed by a registered non-Canadian derivatives dealer into the scope of application, transactions subject to the requirement should be limited to those trading with non-EDP within Canada, similar to the approach taken under the corresponding EU regulations where the scope of application is limited to only those transactions that are deemed to genuinely require customer protection are identified.

[Specific Comments]

1. Condition that all or substantially all of the assets are situated outside Canada (Section 21, 38)

The CSA should clearly define the condition that "all or substantially all of the assets of the derivatives firm may be situated outside the local jurisdiction" and also limit the scope of derivatives parties to which a written disclosure should be delivered to those parties located within Canada.

(Rationale)

The words "all or substantially all of the assets" should be clarified as its meaning is not necessarily clear. CSA should confirm that at least those firms located outside Canada and having a Canadian branch meets this condition. Furthermore, if the requirements in the Proposed Instrument are applied to all derivatives dealers, all transactions between non-Canadian derivatives dealers will also be subject to the requirements, imposing excessive regulatory burdens on financial institutions in foreign jurisdictions. Therefore, in order to

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ensure that this disclosure requirement will not apply to all of the foreign derivatives dealers' counterparties, the scope of its application should be limited to their counterparties located within Canada.

2. Scope of the exemption for foreign derivatives dealers (Section 38)

Foreign derivatives dealers in jurisdictions whose corresponding requirements are deemed to be equivalent to the requirements in the Proposed Instrument should not be required to satisfy the conditions to qualify for the exemption from specific requirements in the Proposed Instrument, but instead should be allowed to be exempted without conditions. If this request is not accepted, the CSA should clarify the scope of this exemption.

(Rationale)

Our view on the exemption for foreign derivatives dealers is as noted in section 1. of the General Comments. If, however, our request is not accepted, the CSA should clarify the scope of the exemption. While our understanding is that the Proposed Instrument is applicable to "derivatives transactions executed and booked within Canada," Section 38 gives rise to uncertainty as to whether the exemption thereunder is applicable to those transactions within Canada, concurrently being subject to their national regulations. More specifically, we are uncertain whether, if Japan is listed as an exempted jurisdiction in Appendix A, the exemption under Section 38 will apply to derivatives transactions that are entered into by Japanese banks and become subject to both Japanese and Canadian regulations, and Japanese banks will only need to comply with the Japanese regulation and be exempted from the requirements in the Proposed Instrument pursuant to Section 38.

Furthermore, if a third country other than Canada and Japan is designated as an exempted jurisdiction in Appendix A and Japanese banks become subject to both the regulations of that jurisdiction and Canada, it is also uncertain whether Japanese banks will be exempted from the requirements in the Proposed Instrument so long as they comply with the regulation of that third country. (For example, where EU is designated as an exempted jurisdiction in Appendix A and Japanese banks comply with EMIR or MiFID II for their EU-related transactions, it is not clear whether Japanese banks will be exempted in accordance with Section 38.)

3. Definition of "eligible derivatives party ('EDP')" (Section 1)

We understand that all derivatives parties referred to in Section 1 are defined as an EDP under the condition that they are "organized under the laws of Canada or a jurisdiction of Canada or that has their head office or principal place of business in Canada." Is our understanding correct?

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(Rationale)

This point needs to be clarified because the current description in Section 1 – Definition of eligible derivatives party does not specify this, which could lead to an interpretation that all transactions between non-Canadian parties are subject to the requirements in the Proposed Instrument.

4. Exemption for transactions on trading facilities, etc.

We believe it appropriate to exempt transactions that are executed on a trading facility or are centrally cleared. In addition to these transactions, FX forwards and FX swaps should also be exempted.

(Rationale)

We understand that transactions executed on a trading facility as well as transactions centrally cleared are appropriately supervised by Canadian authorities.

FX forwards and FX swaps are traded in those markets with relatively high liquidity and transparency. Also, there is a mechanism in place to mitigate their settlement risk. In light of these situations, the U.S. Commodity Exchange Act exempts these products from the scope of application.

Sincerely,

Hideharu Iwamoto
Vice Chairman and Senior Executive Director

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September 16, 2018

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Dear Sirs/Mesdames of:
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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

Re: Canadian Securities Administrators ("CSA") Notices and Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the "Business Conduct Proposal") and National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (the "Registration Proposal") (collectively the "Proposals")

This comment letter is submitted on behalf of the Canadian division ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the legislative proposals referred to above.

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About AIMA

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment funds, futures funds and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises over 1,900 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2 trillion in assets under management. AIMA Canada, established in 2003, now has more than 150 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Advisers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our web sites at canada.aima.org and www.aima.org.

Comments

Set out below are our comments on the Proposals, broken down between general comments and responses to specific questions from the Proposals relevant to our members, which have been replicated in each section for ease of reference.

AIMA Canada appreciates the opportunity to comment on these proposed changes, which if adopted could have significant consequences on Canada's investment industry.

We commend the CSA for their continuing analysis and consultation with respect to the issues and potential regulatory responses regarding the regulation of over-the-counter ("OTC") derivatives. AIMA Canada agrees that, in light of the 2008 financial crisis, enhanced regulatory oversight of the OTC derivatives market is required. We urge the CSA, however, to consider all regulatory developments, both internationally and domestically, and consider their effect on investors and advisers before imposing a potential additional layer of regulatory requirements that may in fact be unnecessary or the cost of which may outweigh the intended benefits.

GENERAL COMMENTS

1. ***Exemption of Foreign Exchange Forward Contracts and Swaps ("FX Forwards") from the Proposals***

The Proposals apply to OTC derivatives as defined by the various provincial regulations. In Ontario, OSC Rule 91-506 *Derivatives: Product Determination* effectively defines FX Forwards as OTC derivatives (which is consistent with the product determination rules in all other Canadian jurisdictions). **Notwithstanding this definition, AIMA Canada recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within defined parameters which**

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are set out below.

Treatment of FX Forwards By Other Regulators

For the purposes of regulation, FX Forwards have been excluded from the definition of OTC derivatives, for the purposes of regulation, by other regulatory and oversight authorities. We recommend that this approach be followed by the CSA for both international consistency and to maintain the competitiveness of the Canadian investment industry.

- In November 2012, the U.S. Department of the Treasury issued a final determination that FX Forwards would be exempted from certain mandatory derivatives requirements as part of the implementation of the Dodd-Frank Act. As a result, the U.S. Commodity and Futures Trading Commission ("CFTC") exempted FX Forwards from various monitoring and reporting requirements.

- In March 2015, the Basel Committee on Banking Supervision (the "BIS Committee") and the International Organization of Securities Commissions ("IOSCO") issued a paper on Margin Requirements for Non-Centrally Cleared Derivatives. In Requirement 1, paragraph 1.1, of this paper the BIS Committee and IOSCO state that "The margin requirements described in this paper do not apply to physically settled FX forwards and swaps."

- In February 2017, the Office of the Superintendent of Financial Institutions exempted physically-settled FX Forwards from the requirement to deliver initial and variation margin in Guideline E-22 *Margin Requirements For Non-Centrally Cleared Derivatives*.

With respect to the FX Forwards market, the above exclusions were deemed acceptable in light of the following factors with respect to the FX Forwards market:

a) Foreign exchange is unique as an OTC derivative in that the vast majority of FX transactions are short-term, thereby posing significantly less counterparty risk requiring oversight and regulation.

b) Foreign exchange transactions worldwide are already subject to strong, internationally coordinated oversight through central banks, with a well-functioning settlement process.

c) The transactions are often closely tied to the participants' funding and liquidity management activities.

d) Physically settled foreign exchange transactions should be viewed as money market or funding products. By definition such transactions are an agreement to deliver the full principal amount of one currency in exchange for the full principal amount of another currency. There are no "derivative" aspects to these transactions as participants know the exact extent of their obligations throughout the life of the contract.

Given these factors AIMA Canada recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within the following parameters:

a) FX Forwards are used by an entity registered as a securities adviser for risk management or hedging purposes linked to securities advising activities;

b) The FX Forward contracts have fixed terms requiring a physical exchange of currency; and

c) The average maturity of the portfolio of FX Forwards of the registrant is less than one year.

2. Fees – Division 2 Suspension and revocation of registration – derivatives firms (Companion Policy of Registration Proposal)

The Companion Policy states that a registered derivatives firm must pay fees every year to maintain its registration and that of its sponsored individuals. AIMA Canada asks the CSA to ensure that any additional proposed fees to be proposed are minimized for existing registered firms when the proposals are published for consultation.

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In particular we ask the CSA to confirm that there will not be any duplication of fees for registered individuals already acting in the same or similar capacities for their registered firms. In particular this would apply to the ultimate designated person ("UDP") and the chief compliance officer ("CCO") as they will likely be the same individuals under both the Registration Proposal and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"). It could also apply to an advising or dealing representative. There is no additional regulatory oversight required for an individual to be registered under both regimes, hence there should not be additional fees.

3. Exemption for International Derivatives Advisers

The Proposals provide for very limited exemptions for international firms, much more limited than the international exemptions found in NI 31-103. We recommend that the Proposals be aligned with NI 31-103 in this respect, to ensure harmonization across the regulatory regimes (which apply to the same set of regulated entities) and to avoid international firms avoiding the Canadian marketplace. It is not apparent to us why the international dealer exemption, the international adviser exemption and the international sub-adviser exemption, each as found in NI 31-103, cannot be mirrored for the OTC derivatives registration regime in the Proposals. We caution that not doing so may result in international firms being unwilling to provide services to the Canadian marketplace, which will ultimately harm Canadian investors by reducing choice and increasing costs.

To that end, **we recommend that:**

- An equivalent of the international sub-adviser exemption be available to firms with respect to OTC derivatives activities. It would be an unusual result that a firm relying on the international sub-adviser exemption for securities law purposes would have to register as a derivatives adviser, and be subject to extensive business conduct requirements, simply for sub-advising on a mandate that included OTC derivatives. As an international sub-adviser may only advise a registered Canadian adviser or dealer, specifically where that latter registered firm has agreed to ensure the international sub-adviser fulfill its fundamental obligations under Canadian securities laws, we do not see a policy concern arising as a result of the introduction of such an exemption in the Proposals.

- Equivalents of the international dealer exemption and the international adviser exemption be available to firms with respect to OTC derivatives activities. The terms of the these exemptions should be identical to the terms found in NI 31-103. We see no policy reason why such exemptions should not be available to firms that deal in or advise on OTC derivatives.

If these exemptions are not included, international firms, operating both in the securities and the OTC derivatives space, would face the unusual regulatory outcome of having to comply with one set of exemptions for their securities activities, and other set of requirements for their OTC derivatives activities, with no apparent reason or justification for this different regulatory treatment.

4. Senior Derivatives Manager

We have concerns with the multiple oversight and supervisory roles presented in the Proposals. In particular, we have concerns with the senior derivatives managers position – firms with limited activity in OTC derivatives may cease to undertake such activities rather than sustain the cost and time to build out systems associated with this role. It is onerous to require firms to designate an additional un-registered individual who fulfils substantially the same role as registered individuals (UDP, CCO and CRO). We see this as a particular concern for international firms with a small number of Canadian clients. Imposing requirements that are inconsistent with other major jurisdictions, particularly the United States, could negatively impact in a decrease in the competitiveness of the Canada marketplace and ultimately result in less expertise being made available to Canadian clients.

CSA QUESTONS

Definition of eligible derivatives party
(Business Conduct Proposal Q#2, Registration Proposal Q#3)

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please

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explain your response.

In our opinion the criteria are appropriate as they are largely consistent with the definition of Permitted Client under NI 31-103. We strongly encourage consistency between the instruments given that the Proposals contemplate a parallel or overlapping registration regime.

Application of derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation
(Registration Proposal Q#4)

We understand that a registered adviser under securities or commodity futures legislation may provide advice in relation to derivatives or strategies involving derivatives or may manage an account for a client and make trading decisions for the client in relation to derivatives or strategies involving derivatives. If the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities, we may consider the registered adviser/portfolio manager to not be "in the business of advising others in relation to derivatives".

(a) Do you agree with this approach? If not, why not? Alternatively, should we consider including an express exemption from the derivatives adviser registration requirement for a registered adviser under securities or commodity futures legislation? If yes, what if any conditions should apply to this exemption?

(b) When should the provision of advice by a registered adviser/portfolio manager in relation to derivatives be considered incidental to the performance of their activities as a registered adviser/portfolio manager? What factors should we consider in distinguishing between registered advisers who need to register as derivatives advisers from registered advisers that do not need to register as derivatives advisers?

Registered advisers under securities or commodity futures legislation ("securities advisers") should not be required to register as derivatives advisers where their advice with respect to derivatives is incidental to their securities advising because it is important to ensure (i) that the designation as a derivatives adviser is meaningful and does not automatically require all securities advisers to also register as derivatives advisers, (ii) that registration as a derivatives adviser is required only where such registration satisfies some regulatory vacuum, such as proficiency or investor protection, and (iii) on a cost-benefit analysis, any additional regulatory burden is not lightly imposed on participants in the investment management industry. Securities advisers and other participants in the asset management industry are already subject to constantly changing, overlapping and costly regulation across multiple jurisdictions.

We recommend that the CSA provide an express exemption from the derivatives adviser registration requirement for the benefit of the following three categories of securities advisers. Those managers of investment funds and accounts that (i) enter into derivatives transaction for the purpose of hedging against a particular identified risk that is inherent in the securities or other assets in which they typically invest, such as interest rate and currency exposures (to the extent that FX Forwards are not exempted as set out above), (ii) enter into one or more derivatives transactions for the purpose of obtaining a long or short exposure to the securities or other assets in which they typically invest directly, such as an equity swap, and (iii) otherwise enter into derivatives that are incidental or ancillary to their stated investment strategy. Many securities advisers that manage investment funds and accounts need to maintain the flexibility to enter into derivatives transactions to hedge against certain risks inherent in their respective portfolios and would benefit from having the ability to use derivatives to obtain exposure to a particular asset in the class of assets in which they typically invest. However, given a securities adviser's obligations to its clients under existing rules, it would be redundant to also require a securities adviser to also register as a derivatives adviser.

In order to qualify for such an exemption, the securities adviser should be required to enter into the trade with a registered derivatives dealer or a domestic or international derivatives dealer that is exempt from registration (including a federally regulated financial institution where such entities are exempt from registration). An additional requirement for relying on this exemption is that the stated investment strategy of the applicable investment fund or managed account should expressly provide in writing the core investment strategy and should include disclosure of the circumstances where the securities adviser may use derivatives pursuant to the exemption referred to in the Registration Proposal. In furtherance of this exemption, and to enhance the protection of the investors and beneficial owners of the funds and managed accounts, the definition of "eligible

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derivatives party" should be amended in the Business Conduct Proposal so that investment funds and managed accounts advised by a securities adviser (in (k) and (l) of the definition) are not included in the definition. In the alternative, such investment funds and managed accounts should have to elect to be treated as an eligible derivatives counterparty. The later approach is probably appropriate for all of the parties that constitute eligible counterparties after part (c). Many of the parties referred to in (d) to and including (l) may benefit from the additional protections afforded to parties other than eligible derivatives parties under the Business Conduct Proposal.

Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives.
(Registration Proposal Q#6)

We understand Subsection 16(3) and subsection 16(4) provide an exemption from the requirement to register an individual as a derivatives dealing representative or as a derivatives advising representative in certain circumstances. Are the exemptions appropriate? In subparagraph 16(4)(b)(ii), individuals that act as an adviser for a managed account are not eligible for the exemption from the requirement to register as a derivatives advising representative. Is this carve out appropriate where an individual has discretionary authority over the account of an eligible derivatives party?

We believe that the exemptions in subsections 16(3)(a) and 16(4)(a) are not appropriate to the extent that they would still require registration when advising an affiliated investment fund. The majority of AIMA Canada's members manage proprietary or affiliated pooled funds sold to accredited investors. As the creators and managers of such funds they are intimately aware of their strategies and management. We do not believe there is any reason to distinguish proprietary investment funds from other affiliated entities; especially as such investment funds qualify as eligible derivatives parties. We recommend that affiliated investment funds not be carved out of the definition of affiliated entities.

It is also our opinion that the carve out in subparagraph 16(4)(b)(ii) with respect to managed accounts is not appropriate and is inconsistent in its application. Under the terms of the provision as written an individual would not be required to register as a derivatives advising representative if the firm is managing or sub-advising an arm's length investment fund since it is an eligible derivatives party and is not a managed account. However registration would be required for a managed account. So, for example, there are different registration requirements if a pension fund invests in an arm's length fund (no registration) vs. having the registrant manage a separate account for a pension fund (registration required).

There is an additional inconsistency between subsections 16(4)(a) and 16(4)(b). An individual would be required to register when advising a proprietary fund (s. 16(4)(a)) but not when advising an arm's length fund (s. 16(4)(b)). In our opinion there is no reason to distinguish the two instances when the same services are being provided.

These inconsistencies should be resolved such that the requirements are identical no matter the fund (proprietary or arm's length) or the vehicle chosen by the client (fund or managed account). We would agree with the suggestion to allow an exemption from registration when the managed account is held by an eligible derivatives party (i.e. subsection (b)(ii) should be deleted). Allowing such an exemption is consistent with the treatment of an investment by an eligible derivatives party in a fund and with the changes made in the Business Conduct Proposal that recognized that the managed accounts of eligible derivatives parties require less protection than non-eligible derivatives parties.

Specific Proficiency Requirements for Individual Registrants
(Registration Proposal Q#7)

Subsections 18(2) through (6) of the Instrument establish specific proficiency requirements for each individual registration category. Are these specific requirements appropriate? If not what specific exams, designations or experience are appropriate?

The Quebec regulator currently requires relevant experience relating to each type of derivatives instrument (futures, forwards, options, etc.) in respect of which an individual seeking registration as a derivatives advising representative pursuant to the *Derivatives Act* (Quebec) intends to advise, but this is not expressly set out anywhere. This has the practical effect of resulting in registered derivatives advisers being limited in respect of their derivatives advising activities to the types of instruments for which sponsored individuals have been

registered.

Unless the CSA wishes to create a regime where registered derivatives advisers are limited to particular categories of derivatives (in effect making each derivatives adviser a restricted derivatives adviser), we would recommend that the CSA clarify that any experience advising with respect to any category of derivatives is sufficient for an individual to be registered as a derivatives advising representative. It should be noted that individuals who advise with respect to one category of derivatives are invariably exposed to the entire universe of derivatives instruments and therefore are proficient across all types of derivatives instruments and underlyings.

Derivatives Ultimate Designated Person
(Registration Proposal Q#8)

Subparagraph 27(3)(c)(i) requires a derivatives firm's ultimate designated person to report any instance of non-compliance with securities legislation, including the Instrument, relating to derivatives or the firm's risk management policies if the non-compliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?

We believe that this requirement is not appropriate. It is the responsibility of the CCO and management to deal with such situations, including through the annual reports to the Board by the CCO and chief risk officer ("CRO"). We also note that this requirement would be inconsistent with any requirements under NI 31-103.

Minimum requirements for risk management policies and procedures
(Registration Proposal Q#10)

Section 39 sets out the minimum requirements for risk management policies and procedures. Are any of the requirements inappropriate? Are the requirements for an independent review of risk management systems appropriate?

In our opinion the requirements in subsection 39(2) for Board approval of risk management policies and procedures and subsection 39(4) for an independent review are not appropriate. These procedures will be a part of the overall policies and procedures of a firm. A registrant is already required to establish policies and procedures designed to establish a reasonable system of controls and supervision (section 38), consistent with the requirements of NI 31-103. The approval, administration and monitoring or review of policies and procedures is the responsibility of management and the CCO and CRO, including through the annual reports to the Board. Singling out the risk management policies and procedures for approval and review is not required as they are part of the overall management of the firm. These provisions would be inconsistent with NI 31-103, which has no equivalent requirements.

We also note that an independent review could be very costly, especially for a small firm without an internal audit function. It is unreasonable to expect such a review for a portion of a firm's systems that are already the responsibility of management and are subject to regulatory review.

Conclusion

In conclusion, AIMA Canada:

1. Recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within defined parameters, as outlined in this letter. This is consistent with international recommendations from both IOSCO and the BIS Basel Committee and practice in the U.S. and would preserve the competitiveness of the Canadian industry.

2. Harmonize the ongoing compliance requirements between the Proposals and NI 31-103 and eliminate the senior derivatives manager position requirements.

3. Harmonize the exemptions for international firms between the Registration Proposal and NI 31-103.

4. Exempt securities advisers from the requirement to register as derivatives advisers where their

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activities are incidental to their securities activities and set out clear and actionable guidance for when a derivatives advising activity will be considered incidental to securities advising activities.

We appreciate the opportunity to provide the CSA with our views on the Proposals. Please do not hesitate to contact the members of AIMA set out below with any comments or questions that you might have. We would be pleased to meet with you to discuss our comments and concerns further.

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Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

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Stikeman Elliott

DELIVERED BY ELECTRONIC MAIL **Without Prejudice**

September 17, 2018

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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Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment – Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* and CSA Notice and Second Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

1. INTRODUCTION

We submit the following comments in response to the Notice and Request for Comment published by the Canadian Securities Administrators (the "**CSA**") on April 19, 2018 with respect to Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed NI 93-102**") and Proposed Companion Policy 93-102 *Derivatives: Registration* ("**Proposed 93-102CP**") and in response to the CSA's Notice and Second Request for Comment published on June 14, 2018 with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("**Proposed NI 93-101**") and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* ("**Proposed 93-101CP**"). Collectively, Proposed NI 93-102, Proposed 93-102CP, Proposed NI 93-101 and Proposed 93-101CP are referred to as the "**Proposed Instruments**".

Thank you for the opportunity to comment on the Proposed Instruments. This letter represents the general comments of certain individual members of our Financial Products & Services practice group

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(and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

All references to parts and sections are to the relevant parts or sections of the applicable Proposed Instrument.

2. GENERAL COMMENTS

As a general comment, we applaud the continued effort by the CSA to develop a harmonized framework for the regulation of over-the-counter ("**OTC**") derivatives in Canada and to streamline the fragmented regulatory landscape that existing and prospective derivatives dealers, advisers and other derivatives market participants must currently navigate.

We have elected to provide a single comment letter to address both Proposed NI 93-102 and Proposed NI 93-101 and their respective Companion Policies, as our comments, concerns and recommendations largely apply across the Proposed Instruments.

Our comments and recommendations in this letter relate to several principal themes. Respectfully, in our view,

1. the scope of the Proposed Instruments is overreaching and the rules are misaligned with the realities of both the Canadian OTC derivatives market and global derivatives regulation;
2. the publication of proposed rules with blank appendices impedes the ability of industry stakeholders to assess the real impact of the Proposed Instruments on their businesses and comment in any meaningful way;
3. the Proposed Instruments, as currently formulated, will discourage access by foreign derivatives dealers and advisers to the Canadian OTC derivatives market;
4. the exemptions from registration and business conduct requirements under the Proposed Instruments require additional consideration and revisions; and
5. certain of the self-reporting requirements under the Proposed Instruments are out-of-step with the existing securities regulatory framework and inappropriate, particularly as they interact with the substituted compliance exemptions.

We also address our concerns and make recommendations regarding a lack of harmonization across regulatory instruments and the resulting complexity and compliance cost and burden to Canadian derivatives market participants; the unnecessary introduction of a "senior derivatives manager" concept into established compliance regimes; and additional aspects of the Proposed Instruments and exemptions therefrom.

For the foregoing and other reasons, we believe that the greatest risk of impeding access and thus discouraging participation in Canadian OTC derivatives markets is going to be to Canadian participants that need the increased liquidity and efficiency provided by participating in the global derivatives market.

3. THE CANADIAN DERIVATIVES MARKET AND SCOPE OF THE PROPOSED INSTRUMENTS

As a general comment, we note that the Proposed Instruments draw heavily from the existing securities regulatory regime in Canada. While we support all CSA efforts to align the derivatives and securities registration-related regimes to the greatest extent possible to eliminate duplicative regulation and oversight of dealers and advisers, the CSA must present a derivatives framework that recognizes the fundamental differences between the OTC derivatives markets and securities markets in Canada. The derivatives market primarily functions to allow businesses and, to a much more limited extent, individuals to hedge commercial risks. It is essential that the Proposed Instruments reflect this hedging and the primarily non-retail aspect of OTC derivatives markets, rather than the investment and investor protection focus of securities markets. In our view, as currently drafted, the Proposed Instruments do not adequately take this important distinction into account and,

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consequently, incorporate concepts and provisions that are not appropriate for the regulation of the OTC derivatives market.

For example, the business triggers for determining the application of the rules under the derivatives regime should be specifically tailored to the OTC derivatives market and not simply borrowed from the business trigger indicators that have been historically relied upon in the securities market context. In particular, proprietary trading activity should not be a trigger for registration or determining the applicability of the business conduct rules, regardless of whether the trading activity is frequent or repetitive, or whether the party solicits the transactions. This is acknowledged only in each of the Companion Policies to the Proposed Instruments (wherein the CSA have stated that "organized and repetitive proprietary trading, in and of itself, absent other factors… may not result in a person or company being considered to be a derivatives dealer" for purposes of the Proposed Instruments); however, this position should be clearly set out in the rules to avoid any interpretive inconsistencies, and is particularly important to buy-side institutions such as pension funds.

In addition, we have significant concerns about the resulting lack of alignment of the Canadian OTC derivatives market regime with those of other jurisdictions, particularly given the relative size of the Canadian market. As noted below, the Proposed Instruments introduce potentially significant increased costs and complexity of compliance for OTC derivatives market participants, with the consequential risk that the Canadian market may become an expensive and burdensome regulatory outlier in the global OTC derivatives market. To continue to attract vital foreign participation in the Canadian OTC derivatives market and preserve its depth and liquidity, we respectfully encourage the CSA to focus on developing a regulatory framework that is broadly consistent with recommendations of the International Organization of Securities Commissions ("**IOSCO**") and that is no more onerous or stringent than the U.S. regime.

4. INCOMPLETE RULES

It is imperative that the CSA publish material regulatory proposals of this order with all relevant information, including completed appendices. In particular, we note the fact that the jurisdictions for which substituted compliance is contemplated and the equivalent regulatory requirements to be listed in the schedules to the Proposed Instruments were not identified in these proposals. Consequently, foreign market participants, Canadian financial institutions and IIROC dealer members have no ability to assess how the requirements under the Proposed Instruments will apply to them. This has rendered it more difficult for market participants to assess the real impact of each of the Proposed Instruments on their businesses and provide meaningful and constructive comments on the proposals. We respectfully request that the CSA include complete appendices and schedules in the next publication for comment and provide an extended comment period of no less than 120 days to facilitate a more informed and detailed analysis of the Proposed Instruments.

5. IMPACT ON FOREIGN DEALERS AND ADVISERS

Substituted Compliance

In general, we are supportive of the substituted compliance approach in the Proposed Instruments—particularly in respect of foreign derivatives dealers and advisers—subject to the following observations and recommendations.

We are of the view that the CSA should adopt broad, purposive and outcomes-based substituted compliance exemptions, rather than engaging in a granular rules-based mapping of comparative regulatory requirements. These exemptions should defer as much as possible to foreign rules given the efforts at the IOSCO level and among other global agencies and industry associations to coordinate and harmonize the regulation of OTC derivatives registration and market conduct globally. The CSA's approach to substituted compliance should follow the recommendations of the March

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2014 *Report of the OTC Derivatives Regulators Group (ODRG) on Cross-Border Implementation Issues*[1] which stated that:

> "In line with the G20 Leaders' declaration of September 2013, as well as the G20 Finance Ministers and Central Bank Governors' communiqué of February 2014, ODRG members reached the following understandings with respect to the use of equivalence and substituted compliance as means of deference: a flexible, outcomes-based approach should form the basis of final assessments regarding equivalence and substituted compliance. The final assessments of a foreign regime for equivalence or substituted compliance should be based on regulatory outcomes of that foreign regime, taking into account the different frameworks, local market practices and characteristics across jurisdictions. An equivalence or substituted compliance assessment also should be based on an understanding that similar regulatory outcomes may be achieved through the implementation of detailed rules or an applicable supervisory framework, or both. Such assessments may be made on a broad category-by-category basis, rather than on the foreign regime as a whole. An equivalence or substituted compliance assessment should fully take into account international standards, where they are appropriate, regulatory arbitrage, investor protection, risk importation, prudential and other relevant considerations." [emphasis added]

Given the comparatively small size of the Canadian OTC derivatives market globally, we do not see any compelling policy rationale for the implementation of Canadian requirements that impose duplicative, differential or additional obligations on market participants that are already governed by substantially equivalent requirements in major derivatives markets.

Given the state of derivatives rulemaking globally, we respectfully urge the CSA to defer to the lead foreign regulator's supervision and oversight over the foreign firm and to principles of reciprocity and principles-based substituted compliance, and ask that the CSA remove these conditions in the next draft of the Proposed Instruments.

Conditions of Reliance

We respectfully submit that the requirements under Proposed NI 93-102 for compliance with equivalent requirements or guidelines under the laws of the foreign jurisdiction are inconsistent with and more stringent than the international dealer exemption and international adviser exemption applicable in the securities market context under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"), for no apparent policy reason. As currently contemplated in Proposed NI 93-102, the derivatives dealer and adviser registration exemptions in sections 52 and 59, respectively, of Proposed NI 93-102 are only available where a foreign firm is subject to and in compliance with the requirements of the laws of its home jurisdiction (noting that the appendices of foreign jurisdictions and prescribed laws were not published with Proposed NI 93-102). However, if a foreign firm relies upon an exclusion or exemption (including discretionary relief) from the requirements of its home jurisdiction, the exemptions under Proposed NI 93-102 are unavailable.

Notably, this condition for reliance would give rise to significant interpretation, technical, compliance and enforcement issues which would ultimately render these exemptions unworkable. For example, it would effectively imply a compliance certification by the authorized signatory of Form 93-102F2 *Submission to Jurisdiction and Appointment of Agent for Service,* at personal risk to that signatory. This type of certification would be unrealistic to expect at the point of filing (e.g., without up-to-the moment enterprise-wide internal due diligence). In particular, we think it would create intractable

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[1] A copy of the report is available on the U.S. Commodity Futures Trading Commission website at: https://www.cftc.gov/sites/default/files/idc/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf

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issues for large multi-divisional financial services groups with separate business units and compliance divisions. Accordingly, we would ask that the CSA consider removing the requirements.

With respect to sections 52(1)(d) and 59(1)(d) of Proposed NI 93-102, in our view, the requirement to promptly notify the local Canadian regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction is similarly unworkable and, accordingly, we recommend that it be removed. See our discussion under “Self-Reporting Requirements” below.

The exemptions set out in NI 93-102 sections 52 and 59 would already be restricted to firms operating in foreign jurisdictions determined by the CSA to have equivalent requirements, a condition which does not exist under the international dealer exemption and international adviser exemption requirements under NI 31-103. Moreover, we believe it would be appropriate for these exemptions to be framed on a basis that is similar to the international dealer exemption and the international adviser exemption under NI 31-103. Under these exemptions, specific disclosure is required to be provided regarding the regulatory status of the international participant, thereby allowing the permitted client (which is a carefully circumscribed, narrow category of investors) to determine for itself whether it wishes to engage with the foreign exempt firm.

We note that the requirements under sections 54(1)(c) and 61(1)(c) of Proposed NI 93-102 to notify the local regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction is also unworkable from a cross-border compliance perspective and inconsistent with the existing compliance, self-reporting and enforcement framework of securities regulation. Accordingly, we suggest that these requirements also be removed.

Further, it is our view that it should be sufficient that a foreign dealer or adviser seeking to rely on the registration exemptions in Proposed NI 93-102 or the business conduct exemptions in Proposed NI 93-101 be registered, licensed or authorized under the rules of one of the jurisdictions specified in the applicable appendices, without that jurisdiction having to be the firm’s *home* jurisdiction. For example, a dealer that is a registered swap dealer under CFTC rules but not subject to registration, licensing or authorization in its home jurisdiction should be eligible to rely on the exemption.

These technical issues alone could create a material disincentive for foreign firms and advisers to rely on the exemptions, with consequential adverse effects on liquidity in the comparatively small Canadian OTC derivatives market.

Foreign Dealers and Advisers and the Business Conduct Rule

In respect of Proposed NI 93-101, we have concerns that the implementation of a two-tiered approach to the imposition of business conduct requirements to market participants in the Canadian derivatives market is at odds with the established framework for the regulation of market intermediaries in Canadian capital markets. In particular, as currently drafted, Proposed NI 93-101 would impose additional layers of both principles-based and prescriptive rules on foreign derivatives market participants in a manner that materially differs from the framework applicable to foreign exempt firms operating on the basis of filings-based and other exemptions available to foreign market participants under NI 31-103.

For example, the “fair dealing” model and the corresponding requirement to “act fairly, honestly and in good faith”, the rules governing the identification and management of conflicts of interest and know-your-derivatives party (gatekeeper) obligations may be broadly consistent with IOSCO policy objectives. These obligations may not, however, be implemented in the regulatory frameworks applicable to market participants in the major derivatives markets globally in a manner that can be easily reconciled with the substantive requirements of Proposed NI 93-101.

Respectfully, the CSA has not articulated a compelling rationale for the application of these “first tier” requirements to foreign firms that may, for the most part, already be subject to adequate market protection requirements in the global jurisdictions. Even for leading players in the global derivatives markets, the technical compliance challenges surrounding the interpretation of these differential

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requirements and the development of additional compliance systems to specifically address Canadian-specific market conduct requirements in the institutional market may simply not be worth the trouble. This proposal, combined with the material technical issues surrounding the filings-based exemptions for foreign derivatives dealers and advisers as currently proposed, may have a very real adverse impact on the cross-border OTC derivatives market. We strongly recommend that the terms and conditions of these exemptions be much more closely aligned with the terms and conditions of the international dealer and international adviser exemptions under NI 31-103 which the CSA successfully introduced into the cross-border securities market almost ten years ago.

Further exemption recommendations applicable to foreign derivatives dealers and advisers

Trades through a dealer - We respectfully suggest that the CSA include an exemption for transactions through or to a derivatives dealer that is registered or exempt from registration or otherwise subject to prudential supervision, similar to the inter-dealer exemption set out in section 8.5 of NI 31-103.

Foreign sub-advisory arrangements - We also recommend that the CSA provide an exemption analogous to section 8.26.1 of NI 31-103 (international sub-adviser exemption) to facilitate sub-advisory arrangements between Canadian registered derivatives portfolio managers and foreign managers that employ OTC derivatives trading strategies.

Importantly, the above-referenced exemptions under NI 31-103 are partly based on the premise that any investor protection or public policy concerns are addressed by the fact that such transactions are made through appropriately registered entities.

Trades with EDPs - Since cross-border derivatives transactions may involve multiple business units operating in affiliated firms (e.g., with counterparties potentially interacting with marketing teams, negotiation/documentary teams, finance teams and booking centres in different affiliated entities), we respectfully suggest that Proposed NI 93-102 more accurately address these commercial realities through additional exemptions (similar to subsections 16(3) and (4) for individuals) that would eliminate the need for duplicative registrations and exemptions in the case of transactions with EDPs.

In addition, we respectfully suggest that Proposed NI 93-101 should provide an exemption from relationship disclosure information requirements under section 18, transaction information reporting requirements under section 27 and derivatives party agreement requirements under section 33 where a derivatives firm complies with substantially equivalent harmonized disclosure, reporting and documentary practices that may be developed from time to time by global trade associations in standard industry documentation based on requirements applicable in the major global markets.

In our view, these additional exemptions are necessary and desirable to facilitate the maintenance of longstanding trading and advisory arrangements in the institutional market, particularly where a foreign derivatives participant may not be inclined to rely on the registration exemptions for foreign derivatives dealers and foreign derivatives advisers given the technical compliance challenges associated with those exemptions.

6. EXEMPTIONS FROM THE REQUIREMENT TO REGISTER

In addition to our comments above regarding the exemptions specifically applicable to foreign dealers and advisers under Proposed NI 93-102, we also make the following observations and recommendations:

Trades with an "eligible derivatives party"

We are generally very supportive of the concept of a uniform definition in all Canadian jurisdictions of an eligible derivatives party ("**EDP**") to classify sophisticated derivatives market participants. However, we respectfully suggest that—notwithstanding the differences in securities and derivatives markets, and acknowledging the CSA's response to this feedback following the first comment period relating to Proposed NI 93-101—the definition of EDP should be fully harmonized with the definition

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of “permitted client” under NI 31-103 and that a single term (e.g., “permitted party”) should be used to assist firms in streamlining client screening procedures and systems. Any additional derivatives-specific conditions (e.g., the derivatives-related knowledge and experience requirements in paragraphs (m), (n) and (o) of the definition of an EDP in Proposed NI 93-101 and Proposed NI 93-102) could be incorporated as additional counterparty qualification requirements.

We support the addition of the new “commercial hedger” category of the EDP definition; however, in our view, the minimum net assets condition for commercial hedgers should be eliminated. Under the *Derivatives Act* (Québec) (“**QDA**”) and existing blanket exemption orders applicable in many Canadian jurisdictions (e.g. Blanket Order 91-501 (BC) *Over-the-Counter Derivatives* and Blanket Order 91-507 (AB) *Over-the-Counter Trades in Derivatives*), the qualification of commercial hedgers is not contingent on any net asset condition. The Proposed Instruments purport to restrict this category and consequential access to commercial hedging solutions with no clear policy justification for doing so. Accordingly, we respectfully recommend that the minimum net assets condition in subparagraph (n)(ii) of the EDP definition be deleted.

We note that the definition of EDP includes a category for persons or companies acting on behalf of a “managed account” if certain conditions are met. With reference to paragraph 1(6) in each of Proposed NI 93-101 and Proposed NI 93-102, the purpose of qualifying the definition of “managed account” by reference to “a managed account owned by another person or company” is unclear. This language is inconsistent with the framework of existing exemptions for managed accounts and, in our view, should be removed.

Under paragraph 1(7) of each of Proposed NI 93-101 and Proposed NI 93-102, in determining whether a derivatives party is an EDP, a firm may not rely on a written representation if reliance on that representation would be “unreasonable”. We respectfully suggest that, rather than precluding reliance on a written representation based on a subjective standard of “unreasonableness”, the CSA should consider amending this provision to permit a firm to rely on written representations or other factual statements made by the other party, provided that it does not have reasonable grounds to believe that such representations or factual statements are false. See, for example, the guidance set forth in AMF *Policy Statement Respecting Accredited Counterparties* (Derivatives Act).

In addition, we respectfully submit that the definition of “commercial hedger” should be framed more broadly, consistent with existing definitions of “hedging” under the QDA and various provincial blanket orders, to more clearly capture ordinary commercial hedging activities (e.g., manufacturing inputs, currencies, commodities, interest rates, etc.). Further, the references in Proposed 93-102CP and Proposed 93-101CP to a “significant link” between the transaction and the business risks being hedged is unclear, nor is it clear how this concept reconciles with the definitions of “hedging” in National Instrument 81-102 *Investment Funds* and existing provincial rules. Finally, the new definition refers to “risks that arise from potential changes in value of one or more” of an asset, liability or services. The reference to “value” in that definition is challenging, as the hedger is hedging against the change in the price or cost of an asset, liability or services, rather than its value once owned. Accordingly, we would suggest that the CSA consider leveraging existing definitions for this purpose and clarify the related guidance.

Similar to the exemption from registration under Proposed NI 93-102 for clearing agencies, other entities that are registered or recognized (or exempted therefrom) under applicable Canadian securities laws, such as swap execution facilities and other derivatives trading facilities, should be specifically exempted from application of the Proposed Instruments as well.

Respectfully, the CSA in the jurisdictions outside of Ontario should take this opportunity to fully extend the firm level registration exemptions available under the *Securities Act* (Ontario) to specified financial institutions operating in the other Canadian jurisdictions on the basis that these market participants are otherwise already subject to robust prudential regulation by their principal regulators.

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7. EXEMPTIONS FROM THE BUSINESS CONDUCT RULES

As a general comment, we strongly encourage the CSA to provide for registration and business conduct exemptions that are consistent across both Proposed NI 93-101 and Proposed NI 93-102. Exemptions from the registration requirement should give rise to corresponding exemptions from business conduct requirements. For example, while Proposed NI 93-102 provides for a *de minimis* exemption from certain registration requirements, it is unclear why there is no corresponding business conduct exception under Proposed NI 93-101. In our view, the misalignment of these exemptions will result in unnecessary market confusion and, as such, we strongly support the implementation of harmonized exemptions across both Proposed Instruments.

In addition, we respectfully submit that, failing a much more streamlined treatment of the business conduct requirements and exemptions across Proposed NI 93-101 and NI 31-103, the compliance burden for firms registered to engage in trading or advisory activities in both securities and OTC derivatives will be rendered unreasonably more complex for no clear marginal benefit in terms of investor or market protection. In our view, the focus for market participants should be to apply core business conduct requirements across their businesses, without having to devote valuable compliance resources to implementing technical variations in the business conduct requirements applicable under both Proposed Instruments.

In particular, we suggest that the framework for waiver of business conduct obligations with respect to EDPs should be fully aligned with the corresponding framework for waiver of business conduct requirements under NI 31-103, except where the need for a different approach is demonstrably justified. As currently proposed, Proposed NI 93-101 requires specific written waivers in areas in which such waivers are not required under NI 31-103 for apparently no clear and compelling policy reason.

8. SELF-REPORTING REQUIREMENTS

As noted above in relation to self-reporting requirements for foreign dealers and advisers under Proposed NI 93-102, sections 32 and 43 of Proposed NI 93-101 requires that a derivatives firm report to the regulator or securities regulatory authority “in a timely manner any circumstance in which the derivatives firm is not or was not in material compliance with” that Instrument or securities legislation relating to trading and advising in derivatives in the specified circumstances. In our view, this is troubling and out of step with established rules and practice in the Canadian securities industry, as well as other derivatives markets outside of Canada.

Respectfully, the CSA has not provided a compelling policy rationale to support this radical change of approach which should be the subject of much broader and extended industry consultations. Certain CSA regulators have developed their own jurisdiction-specific tools (e.g., credit for cooperation programs, whistleblowing rules and no-contest settlements) which already create an overwhelming incentive for firms to take ownership of material compliance issues and self-report them to the regulators once they have been uncovered and properly investigated. These types of measures should be expanded rather than introducing a self-reporting regime which conflicts with the existing rules in Canada and in a number of the major OTC derivatives markets globally.

Further, we respectfully question the imposition of a self-reporting requirement on foreign firms as a condition of their reliance on the substituted compliance framework in sections 38 and 43 of Proposed NI 93-101, which in our view, is also very problematic. The circumstances in which non-compliance by the foreign firm with a foreign derivatives rule could create, “in the opinion of a reasonable person”, a risk of material harm to a derivatives party in Canada or to capital markets—a standard that is already difficult in the Canadian market context—are fraught with uncertainty in the cross-border context. The foreign rules listed in Appendix A to Proposed NI 93-101 may be interpreted and enforced in very different ways in the foreign jurisdictions and these differences render this type of exercise almost impossible to conduct.

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Foreign firms that are not subject to mandatory self-reporting obligations in the foreign jurisdictions in which they conduct business would become subject to significantly increased regulatory exposure, particularly in those jurisdictions which have a less remedial and more aggressive enforcement environment. The addition of this self-reporting condition to sections 38 and 43 of Proposed NI 93-101 effectively makes these exemptions unworkable and impossible to rely on, particularly for large financial groups which must carefully coordinate regulatory reporting on a global basis. In the absence of a clear and effective substituted compliance provision, many foreign firms will likely elect to simply opt out of business lines which require compliance with an additional layer of Canadian-specific business conduct requirements.

We also note that such self-reporting requirements under the Proposed Instruments may be inconsistent with a firm's home country regulatory restrictions which may prohibit the reporting or communicating of certain types of breaches of local laws. In Canada, for example, in the financial crimes area under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* as administered by the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) reporting firms are subject to specific restrictions against disclosure of suspicious transactions or activities. As a result, such legal restrictions on disclosure may be in conflict with a firm's obligations under the Proposed Instruments.

Similarly, the substituted compliance exemptions in sections 39 and 40 for derivatives dealers that are IIROC member firms or Canadian financial institutions, contingent on "prompt" self-reporting of "each instance of material non-compliance with a requirement or guideline" are equally problematic and give rise to significant concerns. The requirement to "promptly" self-report non-compliance with a guideline is particularly difficult to reconcile with the current securities regulatory framework and would create significant compliance and enforcement challenges.

In addition, the requirement under section 27 of Proposed NI 93-102 for the derivatives ultimate designated person ("**UDP**") to report instances of non-compliance with Proposed NI 93-102 or other securities legislation relating to derivatives to the applicable securities regulatory authority is also inconsistent with the existing securities compliance, self-reporting and enforcement framework. See, for example, the scope of responsibilities for the ultimate designated person under Part 5 of NI 31-103. Accordingly, we recommend that this requirement be removed from the Proposed NI 93-102.

In our view, any self-reporting requirements of the type contemplated in these Proposed Instruments should be limited to periodic (e.g., annually or quarterly) reporting to the securities regulator of regulatory actions (e.g., non-confidential enforcement actions and settlements) which are already required by the lead regulator to be disclosed (e.g., consistent with the approach taken in Multilateral Instrument 31-102).

9. SENIOR DERIVATIVES MANAGERS

Under Proposed NI 93-102, derivatives firms are required to designate a UDP, a CCO and a Chief Risk Officer. Respectfully, we are of the view that the introduction of the "senior derivatives manager" concept under Proposed NI 93-101 is superfluous and out of step with supervisory and compliance structures under existing securities legislation. Absent any compelling explanation by the CSA as to its rationale, we recommend removing it from Proposed NI 93-101.

As currently proposed, the qualifications, role and responsibilities, and the potential liabilities associated with the "senior derivatives manager" position under section 31 of Proposed NI 93-101 require further consideration and clarification, particularly as the concept applies to smaller firms with no separate business units and to foreign firms which are not subject to similar requirements in their jurisdictions of operation.

In addition, it is unclear why the senior derivatives manager should not have compliance reporting responsibilities to the firm's derivatives UDP, CCO and Chief Risk Officer given their own respective compliance-related responsibilities at the firm-wide level.

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It is also not clear why functions related to the rectification and reporting of non-compliance allocated to the senior derivatives manager under subsections 31(1)(b) and 31(2)(a) and (b) and under related guidance in the Proposed 93-101CP should not be allocated to the CCO, given the need for the UDP and the CCO to oversee and monitor compliance on a consistent and firm-wide basis. The CCO, in particular, may be impeded in the performance of his or her functions if the senior derivatives manager is required to "respond, in a timely matter, to any material non-compliance" rather than to promptly escalate the matter outside the derivatives business unit and report it to the CCO. In certain situations, the senior derivatives manager may be subject to conflicts of interest (e.g., performance and revenue targets), which may lead to biased or inappropriate responses or to inadequate reporting if the senior derivatives manager is not required to engage with the CCO. Senior derivatives managers may not have the same appreciation or comprehensive view of firm-wide risk exposure, which may also lead to inadequate outcomes beyond the specific derivatives business unit.

If the CSA is unwilling to remove the senior derivatives manager requirement from the Proposed Instruments, we strongly recommend that, at a minimum, the requirement to appoint a senior derivatives manager should not apply to firms that restrict their derivatives business to EDPs or to foreign firms that are already subject to similar requirements on an outcomes basis.

10. HARMONIZATION ACROSS INSTRUMENTS

As a general but significant comment, we would suggest that the CSA implement a single set of definitions applicable to both Proposed NI 93-102 and Proposed NI 93-101, as well as harmonize definitions and concepts across other relevant regulatory instruments. This would facilitate a more coherent and workable OTC derivatives regulatory framework. The absence of consistency with other regulatory definitions creates material compliance challenges and, in our view, there is no compelling policy or regulatory reason for these minor technical variations. They add unnecessarily to the compliance burden and associated compliance costs of market participants.

For example, we respectfully question how the definition of "transaction" under the Proposed Instruments is intended to relate to similar definitions under other securities legislation and rules. The definition of "trade" under section 1 of the *Securities Act* (Ontario) includes "a novation of a derivative, other than a novation with a clearing agency", whereas the definitions under the Proposed Instruments refer to "a novation of a derivative, other than a novation with a *'qualifying'* clearing agency". The definition also differs from the definitions of "transaction" for purposes of provincial trade reporting rules which refer to "entering into, assigning, selling or otherwise acquiring or disposing of a derivative or the novation of a derivative". Further, certain requirements of the Proposed Instruments make reference to persons "transacting" in derivatives while others refer to "trading" in derivatives.

Notwithstanding the related guidance in Proposed 93-102CP and Proposed 93-101CP, we urge the CSA to take this opportunity to harmonize the definitions of "Canadian financial institution", "managed account", the definitions used for the purposes of categorizing an EDP and other definitions across all relevant national instruments including, specifically, NI 31-103, National Instrument 45-106 *Prospectus Exemptions*, and the Proposed NI 93-101 and Proposed NI 93-102.

11. ADDITIONAL RECOMMENDATIONS

Implementation and Transition

We respectfully submit that the revised draft of the Proposed Instruments should provide for an extended period of transition (a minimum of two years from the effective date) and broad grandfathering provisions for counterparty qualification requirements (e.g., under the QDA and existing provincial blanket orders), and individual proficiency and experience requirements. This would allow derivatives market participants adequate time to develop and implement internal policies and compliance procedures and update compliance systems.

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Compliance and Risk Management

In connection with the requirements for determining the value of the derivative and the process of dispute resolution under sections 41 and 42, respectively, of Proposed NI 93-102, we respectfully suggest that the CSA consider including a requirement that firms take into consideration prevailing market practices in the global derivatives jurisdictions.

We also note that the requirement in Proposed NI 93-102, section 42(4) for a firm to report to the regulator a dispute that has not been resolved within 30 days of reporting the dispute to its board of directors is not consistent with the existing compliance and dispute resolution framework outside of Quebec. Absent a compelling policy rationale for this requirement, we respectfully recommend that this requirement be deleted.

In respect of the requirement for firms to maintain procedures for portfolio reconciliation and portfolio compression exercises under sections 44 and 45 of Proposed NI 93-102, respectively, we would suggest that Proposed NI 93-102 provide a clear registration exemption for third party portfolio compression and related services and other non-dealer service providers that facilitate these risk mitigation procedures.

Pre-transaction Disclosure

The pre-transaction disclosure requirements set out in section 19 of Proposed NI 93-101 may not be entirely aligned with disclosure practices in the OTC derivatives industry. We think that these requirements should be eliminated. In the alternative, if required, we recommend that they be incorporated into the relationship disclosure information delivery requirements.

Non-targeted Advising

We are of the view that the definition of “financial or other interest” in subsection 57(1) of Proposed NI 93-101 is too vague and should be reconsidered. In particular, sub-clauses (d) (a financial arrangement in relation to the derivative or underlying interest) and (e) (any other interest that relates to the transaction) are very broad and may present unnecessary compliance issues/obstacles for advisers.

* * * * *

Thank you for the opportunity to comment on the Proposed Instruments. Please do not hesitate to contact any of the undersigned if you have any questions in this regard.

Yours truly,

Alix d’Anglejan-Chatillon
Ken Ottenbreit
Sterling Dietze
Ramandeep Grewal
Margaret Grottenthaler
Philip Henderson

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VIA EMAIL

September 17, 2018

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
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Nunavut Securities Office

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Montréal (Québec) H4Z 1G3

Grace Knakowski
Secretary
Ontario Securities Commission
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Toronto, Ontario M5H 3S8

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Proposed National Instrument 93-101 – *Derivatives: Business Conduct* & Proposed National Instrument 93-102 – *Derivatives: Registration*

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") and

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Proposed National Instrument 93-102 – *Derivatives: Registration* (the "Registration Rule", collectively with the Business Conduct Rule, the "Derivatives Rules").

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 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.

The Business Conduct Rule would impose a range of business conduct requirements and the Registration Rule would impose firm and individual level registration 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"). FTIC and its affiliates do not engage in the business of what would constitute a "Derivatives Dealer" under the Business Conduct Rule, but we do engage in the business of what would constitute a "Derivatives Adviser"; therefore, our comments are limited to the impact of the Derivatives Rules on Derivatives Advisers.

We have reviewed and generally support the comments made by The Asset Management Group of the Securities Industry and Financial Markets Association, but we also wish to provide our own comments with respect to the Derivatives Rules.

General Comments

We support the work of the CSA to implement a comprehensive regime for the regulation of persons or companies in the business of advising on derivatives, but we see the Derivatives Rules as duplicative of existing requirements that advisers are already subject to, including under National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registration Obligations* ("NI 31-103"). We believe there is nothing inherently different about advising on over-the-counter ("OTC") derivatives, nor do they pose a unique set of risks, that cannot be addressed through amendments to NI 31-103. Furthermore, we question the creation of new positions (e.g., Senior Derivatives Manager) and new registration categories under the Derivative Rules that seem duplicative and do not exist under NI 31-103. Therefore, FTIC strongly recommends that the Derivatives Rules be integrated with NI 31-103 to create one uniform set of rules for persons advising on both securities and derivatives.

In addition, FTIC urges CSA members to integrate their rules governing other derivatives (e.g., *Commodity Futures Act* in Ontario) into NI 31-103 to eliminate the fragmented regime and duplicative requirements that currently exist.

While FTIC supports the integration of the Derivatives Rules into NI 31-103, specific comments on the Derivatives Rules as currently proposed are detailed below.

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Registration Rule

We are unable to provide meaningful comments regarding the current version of the Registration Rule since the CSA has not yet provided a completed version of Appendix G, which will list the foreign jurisdictions and requirements in those jurisdictions that a foreign derivatives adviser must comply with to be exempt from registration. We may have additional comments after the CSA publishes Appendix G.

It is our view that the foreign derivatives adviser exemption in the Registration Rule should be aligned with the international adviser exemption in NI 31-103, and should include foreign derivatives advisers that are exempt from registration in their principal jurisdiction. In its current form, the Registration Rule only provides an exemption for a foreign derivatives adviser that is registered, licensed or otherwise authorized under the legislation of the foreign jurisdiction to conduct derivatives activities. We believe it should be explicit that persons or companies exempt from registration in their home jurisdiction can also rely on the foreign derivatives adviser exemption.

We also encourage the CSA to include an international sub-adviser exemption in the Registration Rule, which is similar to the exemption that already exists in NI 31-103. In order to rely on such an exemption, a registered adviser must be responsible for the activities of the foreign sub-adviser and provide supervision and oversight of the foreign sub-adviser. For these reasons, we believe adequate protections would exist for clients and, therefore, an international sub-adviser exemption in the derivatives context is appropriate.

The foreign derivatives adviser exemption requires that a foreign derivatives adviser promptly notify the regulator of each instance of material non-compliance with a foreign requirement or guideline listed in Appendix G. We do not understand the rationale for this variation from the international advisor obligations under NI 31-103 and, depending upon how Appendix G is ultimately completed, we believe that this requirement may be overly onerous. Furthermore, it is likely that the need for the derivatives adviser to interpret the reference to "material non-compliance" will lead to different standards being applied by different participants.

As part of a global investment organization, many risk management functions for FTIC are performed by Franklin Templeton employees outside of Canada. These individuals currently perform these functions with respect to derivatives without any registration requirements. Making such individuals become an officer of a Canadian registrant in order to perform their roles under the Derivatives Rules could have unforeseen consequences for the individual and/or the registrant (e.g., tax consequences). We urge the CSA to allow individuals outside of Canada to continue performing these functions for their Canadian affiliates without requiring them to meet certain proficiency requirements or become an officer of the Canadian registrant.

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Business Conduct Rule

We believe that foreign derivatives advisers and sub-advisers that are exempt from registration under the securities legislation of the foreign jurisdiction in which their head office or principal place of business is located outside of Canada should be exempt from obligations under the Business Conduct Rule in order to align the proposed exemption with the international adviser and sub-adviser exemptions from registration currently found under subsections 8.26 and 8.26.1 of NI 31-103.

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. These obligations are also covered by the fiduciary duty owed by an adviser to its clients. FTIC does not believe that there is any reason to, nor that it is appropriate to, impose specific and slightly different requirements in connection with these obligations in the context of derivatives. Furthermore, imposing duplicative requirements between NI 31-103 and the Business Conduct Rule that are similar, but not identical, will complicate compliance with the established standards and practices that are already observed by investment advisers.

Definition of Eligible Derivatives Party

The concept of "Eligible Derivatives Party" ("EDP") is different from the concept of "permitted client" in NI 31-103. FTIC urges the CSA to align the EDP definition with the definition of permitted client in NI 31-103 and to add the commercial hedger definition to reflect the nature of the derivatives marketplace. We note that the commercial hedger definition should be expanded to include the hedging of an asset that the person or company uses in its business.

Conclusion

The differing concepts and protections for various types of investors under NI 31-103 and the Derivatives Rules are confusing and unnecessary. FTIC strongly urges the CSA to draft an integrated rule for all types of investments, especially since a typical client account could hold a mix of securities and derivatives. Having a different set of rules and exemptions for derivatives will increase administrative and compliance burdens for registrants, with no corresponding investor benefit.

If the CSA moves ahead without consolidating the Derivatives Rules into NI 31-103, it should insure the coordinated implementation of the Business Conduct Rule and the Registration Rule given the Derivatives Rules are so inter-connected. The CSA should also provide an appropriate transition period (at least two years) for firms to implement the Derivatives Rules once finalized.

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Thank you for your consideration of this submission. Please feel free to contact me at 416.957.6010 should you have any questions or wish to discuss our submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

Brad Beuttenmiller
Senior Associate General Counsel

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September 17, 2018

DELIVERED VIA ELECTRONIC MAIL

Alberta Securities Commission
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

Me Anne-Marie Beaudoin Corporate Secretary Autorité des marches financiers, 800, rue du Square-Victoria, 22e étage C.P. 246, tour de la Bourse Montréal (Québec), H4Z 1G3 Consultation-en-cours@lautorite.gc.ca	Grace Knakowski Secretary Ontario Securities Commission 20 Queen Street West 22nd Floor Toronto, Ontario M5H 3S8 comments@osc.gov.on.ca

Dear Sirs and Mesdames:

RE: Canadian Securities Administrators Proposed National Instruments 93-101 and 93-102

Canadian Credit Union Association ("CCUA") is pleased to provide comments on the Canadian Securities Administrators' ("CSA") proposed National Instrument 93-101 Derivatives: Business Conduct (the "proposed Business Conduct Rule") and proposed National Instrument 93-102 Derivatives: Registration (the "proposed Registration Rule").

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CCUA is the national trade association for 251 credit unions in Canada outside Quebec that collectively control over $216 billion in assets and serve more than 5.6 million credit union member/owners through 1,800 branch locations.

With one notable exception[1], credit unions are provincially-chartered and regulated co-operative financial institutions that exist to serve their members. While credit unions generate profits for prudential and growth reasons, their primary objective is to meet the needs of their members. For 14 years running, credit unions have earned the top spot in the Ipsos "Best Banking" Awards and have similarly been rated the top service provider in repeated surveys of Canadian Federation of Independent Business (CFIB) members.

Credit unions in turn own and control provincial or regional centrals that provide them with wholesale financial services, liquidity management, payments processing and other 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.

The vast majority of CCUA's credit union members use derivative products strictly for their own commercial hedging purposes.

Our comments are outlined below in three sections. We begin with some concerns with certain definitions that are applicable to both the proposed Business Conduct Rule and the proposed Registration Rule. We will then comment on specific requirements of each proposed Rule.

1. DEFINITION CONCERNS APPLICABLE TO THE BUSINESS CONDUCT RULE AND REGISTRATION RULE:

The definition of "Canadian financial institution":

The definition of "Canadian financial institution" in the proposed Business Conduct Rule is as follows:

> *"Canadian financial institution" means any of the following:*
> *(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*

[1] In 2016, the Caisses Populaires Acadiennes became a federal credit union under the Bank Act (Canada) operating under the trade name of UNI Financial Cooperation

(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.

While we appreciate that this language is reflective of the definition of NI 45-106 Prospectus Exemptions, this definition has legacy language which requires updating. Paragraph (a) of this definition refers to credit union centrals as central cooperative credit societies under s. 473(1) of the *Cooperative Credit Associations Act* (Canada) (the "CCAA"). Section 473(1) of the CCAA provided a mechanism for provincially regulated centrals to "opt in" to federal regulation under the Part XVI of the CCAA. However, in its 2014 Economic Action Plan, the federal government signaled its intention to repeal Part XVI of the CCAA (including s. 473(1)). That repeal was effective on January 15, 2017 and the five provincial / regional centrals returned to being wholly provincially regulated.

On the assumption that the definition of "Canadian Financial Institution" is intended to include all provincially and federally regulated financial institutions, we would therefore propose that the definition of "Canadian financial institution" be amended as follows:

"Canadian financial institution" means any of the following:

(a) ***a federal financial institution as defined in the Bank Act (Canada); or***

(b) ***a loan corporation, trust company, trust corporation, insurance company, treasury branch, credit union, credit union central, caisse populaire, financial services cooperative, or league that is incorporated and regulated by or under an Act of the legislature of a province.***

The definition of "eligible derivatives party" – Commercial Hedger:

We appreciate that the definition of "eligible derivatives party" has been drafted with a specific derivatives perspective as opposed to repeating the definition of "permitted client" in the securities regulatory regime. In particular, we support the addition of a "commercial hedger" category notably as hedger clients have very specific needs, separate and apart from speculators. However, it is unclear on what basis the CSA Derivatives Committee chose to insert a requirement for commercial hedgers to have net assets of at least $10 million. We are not aware that any sort of quantitative assessment has been made that would indicate that $10 million is an appropriate threshold and we would further submit that the financial threshold should not be included in its entirety, or in the alternative, and it be significantly lowered to be no more than $1 million. The existing OTC derivatives blanket orders (in certain CSA jurisdictions) that govern the current regime in many provinces do not include any financial threshold, so it is unclear

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what systemic risk has arisen (or perhaps what analytics have been conducted on the trade reporting data) that warrant this significant financial threshold to be employed.

2. SPECIFIC COMMENTS ON PROPOSED NI 93-101 - BUSINESS CONDUCT RULE:

De Minimis Exemption:

Unlike in the proposed Registration Rule, there is no de minimis exemption (Notional Amount Exemptions) proposed for the derivatives dealer business conduct requirements. While we appreciate that even if a derivatives dealer has only one client that it should still be required to abide by the obligations of Fair Dealing, Conflict of Interest and Know Your Derivatives Party, the burden of having to comply with the balance of the requirements in proposed Business Conduct Rule (in particular the requirements in Part 5 Compliance and Record-Keeping and the need for a separate Senior Derivatives Manager) is inappropriately onerous for firms with a limited business model and comes with a significant cost that outweighs any measured benefit. The need for more prescriptive and process-oriented requirements need to be measured against the burden imposed on small or mid-market firms that pose no systemic risk to the market.

CCUA believes the CSA should apply "proportionality" and a "risked-based" policy lenses to national instruments such as the Business Conduct Rule. 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)[2] .

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 and centrals. 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 Business Conduct Rule 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.

As indicated, we have no objection to compliance with the general market conduct requirements of Fair Dealing, Conflict of Interest and Know Your Derivatives Party but we are concerned with the balance of the Business Conduct rule requirements that would impose an unnecessary and unwarranted burden on smaller institutions.

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[2] For a discussion in a prudential context see: http://www.bis.org/fsi/publ/insightsl.htm

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We would therefore propose that any firm that meets the final thresholds set forth in Section 50 and 51 (limited notional amount) of the proposed Registration Rule be provided with an outright exemption from the requirements in the Business Conduct Rule other than those requirements contained in Division 1 – General Obligations Towards All Derivative Parties.

Further Comment Period:

We understand that Section 40 of proposed Business Conduct Rule provides an exemption from requirements in the Rule for a derivatives dealer that is a Canadian financial institution and is subject to and complies with corresponding conduct and other regulatory requirements of its prudential regulator as set out in Appendix C of the Instrument. We further note that the proposed Business Conduct Rule continues to state "as of the time of this publication for comment, the equivalency analysis required to populate the Appendices of the Instrument has not been completed. The Appendices will be completed and published for public comment prior to the Instrument being finalized."

In order to provide meaningful comments to the CSA Derivatives Committee, it is important to understand what obligations and requirements of proposed Business Conduct Rule would be applied to centrals and credit unions and their members. Therefore, once this internal review has been completed by the CSA Derivatives Committee, the proposed Rule must be produced for a third comment period so that the impacted market participants can respond to the final proposed regime. CCUA would be pleased to provide any support to the Committee's further work on the Rule Appendices.

Transition Period:

As a follow-on to the comment above, it remains unclear as to the requirements that Canadian financial institutions (and in particular, centrals and credit unions) will be required to meet under the proposed Business Conduct Rule and this makes the systems and technology build-out timeframes uncertain. The CSA Derivatives Committee has signaled that there will be a 1 year transition period after final publication of Proposed Business Conduct Rule before the instrument takes effect. This will not be sufficient time for our industry to build such systems and prepare for implementation. We would propose a 2 year transition period in order to provide our members time to meet the new requirements.

3. SPECIFIC COMMENTS ON PROPOSED NI 93-102 – REGISTRATION RULE:

Consideration of a "Scope Rule" for Different Regulatory Requirements:

We note that in other foreign jurisdictions, the over-the-counter derivatives regulatory regimes have different instruments to address registration, business conduct, clearing etc. and that different instruments that are required under one set of requirements may

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not be included under another. In the proposed Canadian regime, OSC Rule 91-506: Derivatives: Product Determination (and equivalent in other jurisdictions), otherwise known as the "Scope Rule", not only confirms what types of instruments should be reported under the trade reporting rules but it is the same "Scope Rule" that governs registration and business conduct.

We would propose to the CSA Derivatives Committee to review the instruments caught in the scope rule. In particular we question the decision to include in the definition of derivative, the purchase or sale of a foreign currency settling in more than two business days (ie. FX forward, deliverable or non-deliverable).

Foreign exchange contracts are commonly used by credit unions and its end user clients to hedge risks associated with its commercial business. We would respectfully submit that the simplicity of these trades and highly transparent foreign exchange market do not pose a systemic risk to the Canadian capital markets to justify a registration requirement.

We further note that unlike more sophisticated derivative instruments like interest rate swaps and credit default swaps, there is no global harmonization over the regulation of over-the-counter foreign exchange instruments.

Lastly, the CSA contemplated that the application of the Product Determination Rules could vary depending on the particular regulatory instrument under consideration. For instance, the following is stated in CSA Consultation Paper 91-301 – Model Provincial Rules – Derivatives Product Determination and Trade:

"The Committee expects that elements of the Scope Rule, subject to necessary amendments, will also be made applicable to certain provisions of securities legislation, and to additional derivatives rules that will be brought into force, including but not limited to rules relating to over-the-counter central counterparty clearing, end-user exemptions, trading platforms, capital and collateral, and registration. <u>However, there may be variations in the application of the Scope Rule for these other rules. In particular, certain contracts or instruments that are prescribed to be securities or derivatives for the purposes of the TR Rule may be treated differently in other rules</u>." [emphasis added]

Need for Harmonization Across the CSA:

We appreciate that Ontario's Securities Act provides that certain specified financial institutions are exempt from registration and as a result, the Ontario Securities Commission (the OSC) will not register those specified financial institutions when they act as derivatives dealers or advisers in the Ontario market. Based on the existing prudential obligations and oversight of centrals and credit unions, we support the OSC's position that registration is not required of a Canadian financial institution. We reference again our above-noted suggested definition for "Canadian Financial Institution".

With regards to the balance of the provincial securities regulators, there currently exist a number of blanket orders and other derivatives legislation that provides for a registration exemption for centrals and credit unions. It is unclear as to what statistical data has been reviewed or market analysis completed that indicates that the existing regime is not adequate and that these market participants pose any systemic risk that warrants a prescriptive securities regulatory regime as opposed to the current prudential regulation of credit unions in each province.

Additional Comment Periods Required to Address and Review Appendix F:

The proposed Registration Rule contains an exemption for Canadian financial institutions where they are subject to and comply with equivalent requirements imposed by a federal or provincial prudential authority. We appreciate that the CSA Derivatives Committee has completed an analysis of the requirements that apply to financial institutions that are regulated by OSFI and by the Autorité des marchés financiers (AMF), however, this is not of assistance to other Canadian financial institutions.

As noted above with regards to proposed Business Conduct Rule, in order to provide meaningful comments to the CSA Derivatives Committee, it is important to understand what obligations and requirements of the proposed Registration Rule would be applied to centrals and credit unions and their members. Therefore, once this internal review has been completed, the proposed Registration Rule must be produced for a lengthy second comment period (minimum of 150 days) so that the market participants can review and respond accordingly. CCUA would be pleased to participate in this review process.

Notional Amount Thresholds:

Notional amount is used in sections 50 and 51 of proposed Registration Rule to establish exemptions from registration for certain derivatives dealers that have a monetary notional amount below a prescribed threshold ($250 million in section 50 and $1 billion under commodities derivatives in section 51).

Given the onerous requirements proposed in the Registration Rule, we respectfully submit that these thresholds be increased to a minimum of $500 million under section 50 and that the amount for commodity derivatives remains the same.

Transition Period:

As noted above, given the significant obligations set forth in the proposed Registration Rule, the transition period should be extended to a minimum of two years.

Conclusion

CCUA is grateful for the opportunity to share its views on the proposed Derivatives Business Conduct Rule and the proposed Registration Rule. We would be pleased to

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provide any additional information as required with respect to our comments. Please do not hesitate to contact me at boconnor@ccua.com or directly by phone at 416-232-3405.

Yours sincerely,

Brenda M. O'Connor
Vice President, General Counsel
& Corporate Secretary

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OLYMPIA
TRUST COMPANY

Via Email

September 17, 2018

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Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia 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
Ontario Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct*, Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration*

Olympia Trust Company ("**Olympia**") is grateful for the opportunity to provide comments to the Canadian Securities Administrators (the "**CSA**") with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct*, Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (collectively, the "**Proposed National Instruments**").

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About Olympia

Olympia is a non-deposit taking trust corporation formed under the *Loan and Trust Corporations Act* (Alberta). Olympia is licensed to provide trust services in the Provinces of Alberta, British Columbia, Saskatchewan, Manitoba, Quebec, Nova Scotia, Prince Edward Island, New Brunswick and Newfoundland and Labrador.

Olympia's Foreign Exchange division provides its customers with the ability to exchange currencies using spot trades and forward contracts, and is principally focused on providing individuals and small and medium sized corporations with a cost-effective currency exchange alternative to the major financial institutions. Olympia's Foreign Exchange division has allowed over 9,000 of its customers to exchange approximately $20 Billion in currencies over its 13 years of operation.

Expansion of the Definition of "Eligible Derivatives Party"

It is Olympia's view that paragraph (o) of the definition of "Eligible Derivatives Party" as set forth in the Proposed National Instruments should be expanded to be consistent with definition of "Accredited Investor" as set forth in National Instrument 45-106: *Prospectus Exemptions* ("**NI 45-106**"). Olympia notes that subparagraph (o)(ii) of the definition of "Eligible Derivatives Party" is substantially the same as paragraph (j.1) of the definition of "Accredited Investor". It is Olympia's view that paragraph (o) of the definition of "Eligible Derivatives Party" should be substantially expanded to include the other categories of individuals identified in the definition of "Accredited Investor", specifically:

(a) individuals who, either alone or with a spouse, beneficially own financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $1,000,000;

(b) individuals whose net income before taxes exceeded $200,000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded $300,000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year; and

(c) individuals who, either alone or with a spouse, has net assets of at least $5,000,000.

Olympia notes that even with the above additions to paragraph (o) of the definition of "Eligible Derivatives Party" the standard required of individuals wishing to be categorized as an Eligible Derivatives Party is still more onerous than the standard required of individuals wishing to categorized as an "Accredited Investor". Olympia reaches this conclusion largely as a result of the provisions subparagraph (o)(i) of the definition of "Eligible Derivatives Party" which require that the individual represent that: "he or she has the requisite knowledge and experience to evaluate the information provided to the individual about

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derivatives by the derivatives firm, the suitability of the derivatives for the individual, and the characteristics of the derivatives to be transacted on the individual's behalf". The definition of "Accredited Investor does not have a corresponding requirement.

Olympia is also of the view that the definition of "Eligible Derivatives Party" should be expanded to include corporations and other entities that are controlled by individuals who otherwise meet the definition of "Eligible Derivatives Party". Such a revision would be substantially similar to paragraph (t) of the definition of "Accredited Investor" which reads:

> (t) 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 accredited investors,

Olympia is of the view that the proposed regulatory regime should not prevent individuals, who otherwise meet the definition of "Eligible Derivatives Party", from trading derivatives using corporations and other entities that they control.

Net Asset Threshold for "Commercial Hedgers"

Olympia applauds the CSA for its inclusion of "commercial hedgers" in the definition of "Eligible Derivatives Party", but is concerned that the requirement that commercial hedgers have net assets of at least $10,000,000 as shown on its most recently prepared financial statements is too high and is out of step with the other financial requirements contained elsewhere in the definition of "Eligible Derivatives Party". In particular, Olympia notes that under paragraph (o) of the definition of "Eligible Derivatives Party" an individual is only required to own financial assets with an aggregate realizable value before tax but net of any related liabilities of only $5,000,000.

Furthermore, a commercial hedger has the additional requirement of demonstrating that they meet the definition of "commercial hedger". Olympia notes that, as per the companion policies to the Proposed National Instruments, a general representation by a counterparty that they meet the definition of "commercial hedger" is not sufficient. Olympia understands that it is the CSA's expectation that derivatives dealers will establish policies and procedures to reasonably verify that a counterparty does indeed meet the definition of "commercial hedger". Given this additional requirement, it is Olympia view that commercial hedgers should not be subject to a financial requirement that is twice as onerous as that required of individuals.

If anything, the "commercial hedger" category of Eligible Derivatives Party should be structured in such a way as to allow parties who own financial assets with an aggregate realizable value before tax but net of any related liabilities of less than $5,000,000 with the ability to be categorized as an Eligible Derivative Party if they can demonstrate that they are "commercial hedgers".

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Accordingly, it is Olympia's view that commercial hedgers should be required to demonstrate that they own net assets of not more than $5,000,000.

Conclusion

As a provider of foreign currency exchange services, Olympia is concerned that the Proposed National Instruments will create additional barriers to entry to an industry that is already dominated by large financial institutions. Under the Proposed National Instruments, many small and medium sized Canadian businesses with foreign business operations will not meet the proposed definition of an "Eligible Derivatives Party" and will be required to purchase currency risk mitigation products from large financial institutions for 2x to 3x their current cost, or forego such currency risk mitigation products altogether. While Olympia is certain this is not the intent of the Proposed National Instruments, if enacted as proposed, this will likely be an unintended consequence.

Olympia appreciates that the CSA needs to balance the twin goals of investor protection and the encouragement of an open and free capital market, but believe that the Proposed National Instruments may have swung the pendulum too far in away from a open and free capital market. Olympia strongly encourages the CSA to reconsider the financial thresholds set out in the definition of "Eligible Derivatives Party" and whether the CSA's competing policy objectives are being balanced appropriately.

Sincerely,

Craig Skauge

Craig Skauge
President
Olympia Trust Company

Derick Kachuik

Derick Kachuik
Vice-President Foreign Exchange Division
Olympia Trust Company

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September 17, 2018

DELIVERED VIA EMAIL: consultation-en-cours@lautorite.qc.ca
comments@osc.gov.on.ca

Alberta Securities Commission
Autorité des marches 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

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed National Instrument 93-102 *Derivatives: Registration* (collectively, the "Proposed Rules")

The Canadian Life and Health Insurance Association is pleased to provide comments on the Canadian Securities Administrators' proposed National Instruments 93-101 *Derivatives: Business Conduct* (the "Business Conduct Rule") and proposed National Instrument 93-102: *Derivatives Registration* (the "Registration Rule").

The Canadian Life and Health Insurance Association (CLHIA) is a not-for-profit, membership-based organization that represents companies which together account for 99 percent of Canada's life and health insurance business. CLHIA's member companies, through a wide range of products and services, help Canadians to protect themselves and their families against the financial risks surrounding premature death, illness and retirement. These products include individual and group life insurance, supplementary health insurance and individual and group annuities (including RRSPs, RRIFs, TFSAs and Defined Contribution pension plans).

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416-777-2221 www.clhia.ca

Association canadienne des compagnies d'assurances de personnes
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The CLHIA supports the goal of establishing a robust investor protection regime related to derivatives that meets The International Organization of Securities Commission's international standards and which protects participants in the OTC derivatives markets from unfair, improper or fraudulent practices.

Life Insurance Company Operations

Canadian life insurance companies generally participate as end-users in Canadian and foreign derivatives markets, and we understand that the end-user exemptions in Section 49(2) of the Registration Rule and Section 37(1) of the Business Conduct Rule will be relied upon where appropriate to exempt Canadian life insurance companies from the requirements of the Proposed Rules which apply to derivatives dealers and derivatives advisers. A key matter is that life insurance companies do not function as "market-makers" in derivatives.

In addition, insurance contracts have generally been excluded from the application of securities registration requirements. For example, section 8.14 of National Instrument 31-103: *Registration Requirements, Exemptions and Ongoing Registrant Obligations* entitled "Variable insurance contract" specifically exempts trades by insurance companies in certain insurance products. Similarly, section 2.39 of National Instrument 45-106: *Prospectus Exemptions* (NI 45-106) provides insurance companies with an exemption from the prospectus requirements for distributions of certain insurance products including group insurance.

To enhance alignment between the Proposed Rules and existing securities registration requirements, consideration should be given to including in the Registration Rule an exemption for insurance companies dealing in certain insurance products, with such exemption mirroring the language found in section 2.39 of NI 45-106.

Additionally, we would note that OSFI actively regulates life insurance companies as Federally Regulated Financial Institutions with respect to solvency and risks, including the risks associated with derivatives exposure, resulting in a robust regulatory framework.

Investment Management Subsidiaries

Canadian life insurance companies also often have investment management subsidiaries that are registered advisers under Canadian securities legislation with employees who are also registered and provide advice with respect to investments in segregated funds, mutual funds, managed accounts and purchases for general account holdings of life insurers. Some of these insurance company subsidiaries and their personnel may also be subject to registration as derivatives dealers or derivatives advisers in accordance with the requirements of the Proposed Rules.

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In this regard, we note that sections 53(1) and 60(1) of the Registration Rule provide that entities that would be brought within the registration requirements solely as a result of their dealing with, or providing advice to an affiliated entity are exempted from the registration requirement. Section 4 of the Business Conduct Rule includes a somewhat similar exemption for persons or companies in respect of their dealing with or advising an affiliated entity; however, section 4 of the Business Conduct Rule does not, on a strict reading, necessarily provide an exemption from registration obligations.

Given the foregoing, we think it would be more clear as to which persons and entities need to be registered if the exemptions in the Proposed Rules were made consistent. This would mean adding the exemptions from sections 53(1) and 60(1) of NI 93-102 to 93-101 and adding the exemption from section 4 of NI 93-101 to NI 93-102.

Support for CMIC's Submission to the CSA

In this context, at least two large Canadian insurers have participated in developing the submissions of the Canadian Market Infrastructure Committee (CMIC), and the CLHIA wishes to express its general agreement with the concerns raised in the CMIC submissions related to the Proposed Rules.

Given the small size of the Canadian derivatives market and its heavy reliance on global participants, it is vitally important to harmonize with international standards where appropriate. In particular, it is important to harmonize with requirements in the United States. Further detail is also required about what jurisdictions will qualify for substituted compliance. We share the concern that many foreign dealers and advisers will not want to assume increased legal and regulatory risk and compliance burden associated with any unique Canadian requirements. Reduced foreign participation in the Canadian market will result in restricted liquidity and access to foreign advisers, and it will increase costs for Canadian businesses.

We support the goal of avoiding duplicative and / or unnecessary regulation, particularly where the OTC derivatives markets in Canada are functioning well and the costs do not appear to outweigh the benefits. We agree with CMIC's view that it is appropriate to exclude financial institutions which are federally regulated by OSFI from the dealer and adviser registration requirements. We also agree with CMIC's recommendations with respect to derivatives advisory services that are provided by foreign advisers and by non-foreign advisers that are currently registered under Canadian securities legislation.

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The CLHIA appreciates the opportunity to provide its comments on the Proposed Rules. If you require any additional information at this time, please feel free to contact me by email at JWood@clhia.ca or by telephone at 416-359-2025.

Yours truly,

"*James Wood*"

James Wood
Senior Counsel

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ISDA® Safe, Efficient Markets

SENT BY ELECTRONIC MAIL

September 17, 2018

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

Grace Knakowski, Secretary
Ontario Securities Commission
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Email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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Email: consultation-en-cours@lautorite.qc.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*

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] has been actively engaged for many years with providing input on regulatory reforms impacting derivatives in major jurisdictions globally, including Canada. ISDA appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") in response to the

[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 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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notice and request for comments (the "**Notice**") regarding the above-noted Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (the "**Proposed Instrument**") and Companion Policy ("**CP**" and, together with the Proposed Instrument, the "**Proposed Business Conduct Rule**"). In this letter, ISDA wishes to outline areas that we believe require further scrutiny and revision, in addition to our responses to the specific questions posed by the CSA in the Notice, which are included in Schedule A. This comment letter and ISDA's comment letter on the Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed Registration Instrument**") and Proposed Companion Policy 93-102CP *Derivatives: Registration* (collectively, the "**Proposed Registration Rule**") ("**Proposed Registration Rule Comment Letter**") should be read together given the many overlapping issues in the two instruments.

1. General Observations

ISDA commented on the previous version of the Proposed Business Conduct Rule in 2017[2] (the "**2017 Comment Letter**"). While we appreciate that some of ISDA's previous comments were accepted, ISDA is concerned that certain comments were not accepted by the CSA, considering the new requirements that have since been proposed by the CSA in the Proposed Registration Rule. In this letter we wish to reiterate and reinforce select material comments from the 2017 Comment Letter that were not accepted by the CSA, but that we believe are essential to be reflected in a final version of the Proposed Business Conduct Rule. We are also submitting comments in respect of the changes to the previous version of the rule.

ISDA believes that the following issues, if unaddressed, could significantly reduce liquidity in the relatively small Canadian OTC derivatives market due to the unduly onerous compliance requirements and asymmetrical interjurisdictional rules.

2. Exemptions for Foreign Dealers and Advisers

Compliance Reporting Condition

ISDA and its members are very concerned by the proposed addition of a new condition to the exemptions for foreign derivatives dealers and advisers in Sections 38 and 43 of the Proposed Instrument. As proposed, firms that rely upon these exemptions will be required to report to Canadian securities regulators in a timely manner the following:

> *any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to trading in derivatives that is listed in Appendix A and if any of the following applies:*

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[2] The ISDA comment letter on the 2017 version of 93-101 can be found online at http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_2017901_93-101_katherined.pdf

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(i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;

(ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;

(iii) the non-compliance is part of a pattern of non-compliance.

This reporting requirement would greatly exceed the regulatory reporting requirements that apply to most foreign firms in their home jurisdictions. It would also greatly exceed all current reporting requirements for both registered securities firms and exempt securities firms in Canada. Currently, for example, registered dealers and advisers, and certain non-resident investment fund managers that rely on registration exemptions in the provinces of Ontario, Quebec and Manitoba, must file "Notices of Regulatory Action", which generally require reporting of (a) settlements with financial regulators, (b) ongoing investigations of financial regulators and (c) sanctions, penalties or orders imposed by financial regulators.

ISDA believes that the proposed exemptions for foreign dealers and advisers should not include any regulatory reporting conditions, given that any firm that relies on the exemptions will be required to report on regulatory matters to their home jurisdiction regulator. However, if regulatory reporting is made a condition of the foreign dealer and adviser exemptions in the Proposed Instrument, the regulatory reporting must, at minimum, be consistent with a firm's reporting obligations to its home jurisdiction regulator. ISDA therefore strongly encourages the CSA Derivatives Committee to re-consider the proposed compliance reporting condition. If reporting is necessary, firms should be required to report only regulatory actions, as is the case for non-resident investment fund managers that report on Form 32-102F2. Furthermore, the timing of reporting of regulatory actions should be consistent with the timing of reporting required in a firm's home jurisdiction. Accelerated reporting of global regulatory actions to securities regulators Canada is not workable for large multinational firms that must coordinate regulatory reporting on a global scale. ISDA would welcome the opportunity to have further discussions with the CSA Derivatives Committee on the proposed regulatory reporting conditions for foreign dealers and advisers. Absent a reconsideration of the reporting conditions currently Sections 38 and 43 of the Proposed Instrument, there will be a risk that this requirement will deter non-Canadian firms from participating in the Canadian markets, an outcome that ISDA and its members wish to avoid.

Eligibility for Substituted Compliance

As noted previously, the foreign derivative dealers and adviser exemptions in the Proposed Business Conduct Rule are predicated on foreign dealers and advisers being subject to a similar regulatory regime in their home jurisdiction. However, in this second iteration of the Proposed Business Conduct Rule, these jurisdictions and regimes have not yet been identified. The CSA has indicated that the proposed jurisdictions and regimes will be published for comment before the end of 2018. Should the CSA keep the approach to substituted compliance for foreign derivatives dealers and advisers that is currently taken

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in the Proposed Business Conduct Rule then it is essential that the CSA publish for public comment the list of available substituted compliance jurisdictions and laws, along with re-publishing the Proposed Instrument and any applicable revisions in advance of finalizing both the Proposed Business Conduct Rule and the Proposed Registration Rule. In that future publication, ISDA requests that the CSA clarify that exemptions for foreign dealers and advisers will also extend to Canadian branches of foreign dealers and advisers that are subject to a similar regulatory regime in their home jurisdiction.

ISDA also requests that the CSA provide clarity and reassurance that the foreign regulatory regimes and rules that will suffice for an exemption from the Proposed Business Conduct Rule will be the same in all respects as the foreign regulatory regimes and rules that will suffice for an exemption from the registration requirements in the Proposed Registration Rule. Otherwise, foreign firms may be left in an untenable position where they are exempt from registration but not business conduct, or *vice versa*, and may need to separately evaluate ability to rely on exemptions under each rule. For instance, it would cause significant market disruption if the regulatory regime of the U.S. Commodity Futures Trading Commission is not identified for substituted compliance for both the Proposed Business Conduct Rule and the Proposed Registration Rule. If the CSA resolves to list substituted compliance jurisdictions in an appendix to each of the Proposed Registration Rule and Proposed Business Conduct Rule ISDA urges the CSA to harmonize the jurisdictions and availability of exemptions applicable to those jurisdictions on each list.

Furthermore, as discussed in the Proposed Registration Rule Comment Letter, a foreign derivatives dealer should not need to apply to any securities regulator or securities regulatory authority in Canada for exemptive or discretionary relief from the Proposed Business Conduct Rule when such an entity, by way of an exclusion or exemption, is not required to make any similar application in its home jurisdiction.

Notably, the U.S. CFTC has recently signaled its intention to pursue the utilization of a flexible, outcomes-based approach to substituted compliance, and, particularly for swaps execution and cross-border activities of swap dealers, to recommit to deference processes (such as equivalence and substituted compliance) to increase regulatory coordination and reduce market balkanization. Chairman Giancarlo of the CFTC has recently further noted that:

> "When it comes to swaps reforms that do involve global systemic risk transfer [i.e. business conduct and registration], we must pursue multilateral coordination to achieve high levels of comparability on the basis of comity but not on the basis of what is identical. The alternative is a world in which every regulator asserts global jurisdiction over swaps trading abroad by its home-domiciled institutions. This leads to overlapping, duplicative and possibly conflicting regulations that stymie global economic recovery…It is a path that is essential for the growth of not only

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> U.S. markets, but also those of important global partners, such as Singapore [which has a share of the global derivatives market larger than that of Canada]."[3]

Given the CFTC's drive to build consensus among the regulatory community in a global, coordinated manner, ISDA strongly supports the CSA taking a broad approach to assessing substituted compliance while prioritizing an avoidance of disruption of cross border trade flows. Rather than granularly mapping of analogous legal provisions across multiple jurisdictions, we support a comprehensive approach whereby any jurisdiction that is a member of IOSCO would be an appropriate substituted compliance regime. From a policy perspective, ISDA's view is that there is no justification to limiting foreign dealers to registered dealers of only certain IOSCO jurisdictions.

3. <u>Other Business Conduct Exemptions</u>

a. Harmonization of the exemptions provided in the Proposed Registration Rule and Proposed Business Conduct Rule

Unlike in the Proposed Registration Rule, there is no *de minimis* exemption proposed from the derivatives dealer business conduct requirements. With respect, it is unclear why a firm may be entitled to rely on a dealer registration exemption in the Proposed Registration Rule but not an exemption from the application of business conduct requirements. ISDA believes that the dealer business conduct requirements should only apply to dealers who are subject to registration requirements and accordingly the Proposed Business Conduct Rule should have a *de minimis* exemption identical to the exemption in the Proposed Registration Rule.

ISDA further recommends that, in order to ensure consistency with the Proposed Registration Rule, which provides for a carve-out for crown corporations in Subsection 5(c), the Proposed Business Conduct Rule should also provide an exemption for crown corporations.

In ISDA's view, asymmetrical exemptions in the Proposed Business Conduct Rule and Proposed Registration Rule would result in market uncertainty and confusion in an already complex derivatives regime. We therefore strongly encourage the CSA to harmonize the exemptions.

b. Exemption for Trades with a Canadian Derivatives Dealer

Similar to the Proposed Registration Rule, ISDA is concerned that the CSA has not proposed a business conduct exemption for a derivatives party that trades with a Canadian derivatives dealer (for purposes of this section, either a registered derivatives dealer or a regulated financial institution exempt from registration under Section 35.1 of the *Securities Act* (Ontario). The registration exemption in Section 8.5 of NI 31-103 serves an important

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[3] Remarks by Chairman J. Christopher Giancarlo at the ISDA Industry and Regulators Forum, Singapore, September 12, 2018

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function in Canadian securities markets by supporting robust trading and liquidity within Canada and cross-border by enabling unregistered firms, including foreign dealers, to trade securities with Canadian registered investment dealers without the unregistered firm being subject to a Canadian registration requirement. Under the Proposed Registration Rule and Business Conduct Rule, however, a trade between an unregistered firm and a Canadian derivatives dealer could potentially subject the unregistered firm to registration or the need to comply with business conduct obligations, or at minimum the need to conduct an analysis of whether registration and business conduct requirements apply. This may cause significant harm to liquidity in Canadian derivatives markets without any corresponding benefit of protection to Canadian investors or market participants. So long as one party is a Canadian derivatives dealer it serves no purpose for both counterparties to be registered or subject to the requirements of the Proposed Business Conduct Rule. Foreign dealers may be unwilling to perform the required analysis to determine their obligations under the Proposed Business Conduct Rule and avoid transacting with Canadian counterparties unless they are guided to a specific waiver or exemption. ISDA therefore proposes that an exemption for derivatives transactions conducted with a Canadian derivatives dealer be included in the Proposed Registration Rule and the Proposed Business Conduct Rule.

4. **Definition of "eligible derivatives party"**

ISDA remains concerned that the definition of "eligible derivatives party" ("**EDP**") is cumbersome and mostly duplicates other established Canadian client definitions, such as "permitted client", but with slightly higher financial thresholds. As we observe in the Proposed Registration Rule Comment Letter, notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of EDP should include all the persons that qualify as "permitted clients" under NI 31-103.

ISDA appreciates that the CSA has included a category of "commercial hedgers" in paragraph (n) of the definition of EDP. However, as discussed further in the Proposed Registration Rule Comment Letter, absent a clear policy justification for excluding mid-market entities from access to OTC derivatives transactions as qualified EDPs, we believe that either (a) no minimum net asset threshold or (b) a lower net asset threshold of $1 million in net assets at (n) (ii) would be more appropriate for smaller businesses and will continue to result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSAs policy objectives.

As detailed in the Proposed Registration Rule Comment Letter, while we acknowledge that the CSA has taken steps to ensure that commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies, we have concerns with the high threshold for a commercial hedger category of EDP at paragraph (n). There is no minimum financial threshold for hedgers under local blanket orders and exemptions, including the *Derivatives Act* (Quebec), and there is a much lower Eligible Contract Participant ("**ECP**") threshold in the U.S. ISDA respectfully requests that the CSA provide evidence that the exemptions for trading with hedgers that are currently used by OTC derivatives dealers in Canada today are giving rise to an undue risk of harm to hedgers due to their being no minimum financial threshold to

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being a hedger. We expect that introducing a threshold to the commercial hedger exemption will disqualify market participants who may need (and under the current rules, currently have) access to opportunities for effective pricing, as many dealers will opt to only trade with EDPs. Introducing the proposed financial thresholds will almost certainly disrupt current market practice and unfairly impinge access for certain market participants. Respectfully, securities regulatory authorities should not be increasing access thresholds absent clear evidence of harm resulting from the existing rules.

As a final observation on the EDP definition, members of ISDA strongly encourage the CSA to consider that there is a need to align the EDP definition with the "eligible contract participant" definition under the U.S. Commodity Exchange Act. For example, governmental, multinational or supranational government entities, including multilateral development banks and central banks, and entities controlled by, owned by, or wholly guaranteed by the foregoing, qualify as ECPs in the U.S. However, only Canadian and foreign governments and their agencies are considered EDPs under the Proposed Instrument and Proposed Registration Rule. Further, commercial hedgers with over $1 million in net assets qualify as ECPs in the U.S., but must have over $10 million in net assets in order to qualify as EDPs under the Proposed Instrument and Proposed Registration Rule. Harmonizing cross-border rules reduces the regulatory burden for derivatives firms and derivatives market participants. Any deviation to commonly used definitions without a related policy justification will cause a disproportionate compliance burden on Canadian derivatives market participants.

5. Derivatives Party Agreement

Section 33 of the Proposed Instrument requires that all derivatives firms enter into an agreement with a derivatives party before transacting in a derivative with, for or on behalf of that derivatives party. This is not market standard for foreign exchange transactions ("**FX**") in the Canadian market, where firms typically trade using a confirmation, including a SWIFT confirmation, rather than a deemed ISDA Master Agreement (a "**Deemed ISDA**") unless the parties are subject to U.S. Dodd-Frank Act requirements. This provision will necessitate a Canadian-specific ISDA protocol to incorporate a Deemed ISDA into trades where there is no ISDA Master Agreement. Our concern is that, unlike the U.S., foreign dealers will not be willing to adhere to a Canadian specific protocol and will simply trade with other market participants instead. No other jurisdiction with a derivatives market of a comparable size (e.g. Australia) has an ISDA protocol. FX should therefore be excluded from Section 33 of the Proposed Instrument. Alternatively, the CSA could allow firms to comply with the Global Foreign Exchange Committee's FX Global Code of Conduct in lieu of Canadian specific business conduct rules. Given the CSA's concern that the FX code of conduct is not binding, compliance with the FX code of conduct could be included as a condition for substituted compliance for FX so that it would be enforceable by the CSA.

6. Other Issues

Clarity regarding application of business conduct rules to derivatives firms

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ISDA remains concerned about the lack of clarity as to whether the Proposed Business Conduct Rule will apply to all trading activity of a derivatives dealer or derivatives adviser if only a portion of the derivatives dealer or adviser's business involves Canadian counterparties. For example, under the OSFI margin guidelines for non-centrally cleared derivatives, OSFI instructs that Canadian covered entities may comply with the rules of a foreign jurisdiction when trading with foreign counterparties, so long as the rules of the foreign jurisdiction are comparable to the OSFI margin requirements. We recommend that the CSA provide similar guidance on the scope of the Proposed Business Conduct Rules.

Self-reporting requirements

The requirement to self-report certain circumstances of material non-compliance to the CSA is not limited to foreign dealers and advisers, as discussed above. All firms subject to the Proposed Business Conduct Rule will be subject to a self-reporting obligation pursuant to Section 32 of the Proposed Instrument, including (in some circumstances) IIROC dealers (pursuant to Section 39(b) of the Proposed Instrument) and Canadian financial institutions (pursuant to Section 40(b) of the Proposed Instrument). It is not clear to ISDA and its membership whether a new self-reporting requirement layer is necessary given that IIROC dealers and Canadian banks already have significant self-reporting requirements.

The reporting requirements in Section 32 of the Proposed Instrument, which are duplicative of the reporting requirements in Section 27(3)(d) of the Proposed Registration Instrument, are not appropriate. First, there is unnecessary confusion and complexity that results from overlapping compliance requirements in the two instruments. Second, while ISDA strongly supports that derivatives firms must identify and resolve compliance issues that may arise, and further that derivatives firms should be encouraged to self-report material violations of securities legislation, ISDA disagrees with the proposed requirement for derivatives firms to self-report material non-compliance, and to do so on a "timely basis". ISDA believes that imposing a self-reporting requirement greatly exceeds the scope of the Proposed Business Conduct and the Proposed Registration Rule, particularly given that there are no similar self-reporting requirements for other market participants under applicable provincial securities law. The CSA has not provided any justification as to why derivatives firms registered in Canada should be held to a significantly different standard than securities firms registered in Canada or derivatives firms under similar regulatory regimes outside of Canada. In the absence of any such justification, ISDA respectfully requests that the CSA re-consider the self-reporting requirement, or significantly alter the requirement to focus on periodic reporting (annually or quarterly) of regulatory actions (investigations, settlements and orders involving the derivatives firm and a financial regulator).

Registration triggers for acting as a derivatives dealer or adviser

ISDA acknowledges the addition of a more robust description of market making activity in the list of business trigger factors used to determine whether an entity is acting as a derivatives dealer. As we have previously commented to the CSA, ISDA prefers that market making be the only factor to 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

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market making, in the alternative we continue to recommend that the proposed definitions of derivatives dealer and derivatives adviser be revised to more precisely and clearly articulate whether the activities of a derivatives party bring them into the scope of these definitions.

In particular, the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" is problematic and difficult or impossible to apply in practice, particularly for buy-side institutions. As discussed in greater detail in the Proposed Registration Rule Comment Letter, frequent derivatives trading activity, in the absence of the other business purpose factors, should not constitute dealing activities. For example, large buy-side institutions may engage in various types of OTC derivatives transactions with repetition, regularity or continuity. Examples include the hedging of foreign currencies or the frequent trading of OTC equity derivatives. These transactions are not dealing activity and may not squarely fit within the registration exemption for end users in Section 37 of the Proposed Instrument. We also note that this factor is not included in the similar list of factors to identify a derivatives dealer for trade reporting purposes in the companion policy to MI 96-101 *Trade Repositories and Derivatives Data Reporting*. We see no reason why this factor could be relevant to identify a derivatives dealer for business conduct and registration but not trade reporting. We therefore recommend that the CSA remove from the CP the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" as a business trigger or, in the alternative, modify the factor as "directly or indirectly carrying on market-making activity with repetition, regularity or continuity".

Individual responsibility when dealing or advising certain derivative parties

Various requirements, such as suitability in Section 12 of the Proposed Instrument and referral arrangements in Section 13 of the Proposed Instrument, apply to both a derivatives firm or an individual acting on behalf of a derivatives firm. Individual responsibilities could theoretically encompass individuals who are not involved in making the decision to transact (for example, operations, documentation, or legal personnel). The CSA should therefore clarify that individual responsibility should be limited to counterparty-facing individuals (i.e. salespersons, traders and advisers on derivative transactions) or, more precisely, individuals who are required to register as a derivatives dealing representative or derivatives advising representative under the Proposed Registration Rule.

Safe harbour for suitability requirements

In addition to the current exemptions from the suitability requirements under Section 12 of the Proposed Instrument when dealing with an EDP, ISDA believe that a safe harbour mirroring that of Regulation 23.434(b) should be included in the suitability requirements under Section 12 of the Proposed Instrument in cases when the counterparty is not an EDP. Regulation 23.434(b) of the U.S. Commodity Futures Trading Commission contains a safe harbour provision to a dealer's obligation to have a reasonable basis to believe that the recommended derivative is suitable for the counterparty. The safe harbour provision is subject to three pre-conditions in transactions with non-governmental counterparties: (a)

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the dealer must reasonably determine, via a written representation from the counterparty or otherwise, that the counterparty is capable of independently evaluating investment risks with regard to the relevant derivative or trading strategy; (b) the counterparty represents in writing that it is exercising independent judgment in evaluating the recommendations of the dealer with regard to the relevant derivative or trading strategy and (c) the dealer discloses in writing that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of the derivative or trading strategy.

Responsibilities of senior derivatives managers

ISDA appreciates the revisions made to the responsibilities of senior derivatives managers in the Proposed Business Conduct Rule to better reflect existing compliance structures at derivatives firms. However, ISDA continues to note that the proposed senior manager regime may risk deterring foreign dealers and advisers from fully participating in the Canadian market given that it is unique globally as a derivatives-specific regime, and add unnecessary legal and compliance burden to both foreign and domestic dealers and advisers. If the CSA is unwilling to remove the proposed senior manager regime, ISDA recommends that the regime should not apply if a derivatives firm only deals with, or advises, EDPs. Further, with respect to non-EDPs, substituted compliance should be provided on an outcomes basis for dealers subject to prudential or similar requirements that provide for comprehensive compliance and accountability consistent with existing global derivatives regulations.

Books and Records for Foreign Derivatives Dealers and Advisers

ISDA also wishes to propose a wording change to Section 38(3)(d) of the Proposed Instrument to address the legal restrictions that may apply to some Canadian and non-Canadian firms if asked to provide information to the CSA:

> (d) subject to any blocking, privacy or secrecy laws applicable to the derivatives dealer, and, where customary, giving preference to the cooperation between home and host country regulatory authority regarding books and records access, the derivatives dealer undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.

We note that the same wording change should apply to Section 38(3)(d) of the Proposed Instrument and any other sections of the proposed rule that require that materials be provided to a securities regulatory authority. We further note that access to books and records should be limited to books and records relating to transactions with Canadian counterparties.

7. Effective date and scope of Proposed Business Conduct Rule

The requirements in the Proposed Registration Rule and the Proposed Business Conduct Rule should come into effect concurrently, with sufficient time allowed to implement appropriate policies and procedures, train relevant personnel, receive any required

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representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation. We recommend that the CSA provide at least a three-year implementation period, and an implementation date towards compliance-heavy periods at both the beginning and end of the year. A three-year implementation period will allow individuals to qualify under proficiency requirements under the Proposed Registration Rule and will allow both the Proposed Registration Rule and the Proposed Business Conduct Rule to come into force simultaneously.

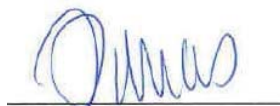
Multiple members of ISDA have also emphasized the importance of CSA publishing the entire Proposed Business Conduct Rule including the proposed appendices for comment prior to its finalization. Without sufficient knowledge over the scope of substituted compliance, market participants will find it impossible to assess the impact of the Proposed Business Conduct Rule.

* * * *

ISDA and its member would like to reiterate our appreciation to the CSA for the opportunity to provide feedback on the Proposed Business Conduct 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.

Yours very truly,



Name: Katherine Darras
Title: General Counsel

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Schedule A:

Specific requests for comment from the CSA

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 "affiliated entity"

The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

Please see Proposed Registration Rule Comment Letter for further comments on the proposed definition. As ISDA has noted in previous comment letters, until such time as the CSA addresses the definition of affiliate more broadly, ISDA believes it is important that the Proposed Business Conduct Rule not create additional uncertainty as to how the term affiliate is to be applied. It would be problematic if a different definition of affiliate were applied in different derivatives rules, such as registration, trade reporting or mandatory clearing rules, and similar securities rules without a comprehensive consultation. We request that the CSA make efforts to avoid the potential for additional uncertainty by avoiding a change to the definition of "affiliate" specifically for the Proposed Business Conduct Rule. ISDA continues to support a separate consultation to understand and improve the definition of affiliate more generally throughout Canadian derivatives and securities regulations.

2) Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Please see ISDA's comment letter responding to the Proposed Registration Rule (reproduced below for reference).

ISDA appreciates that the CSA has included a category of "commercial hedgers" in paragraph (n) of the definition of EDP. We expect that the inclusion of a commercial hedger category will help mitigate the risk that Canadian commercial hedgers will be unduly burdened by the introduction of the Proposed Registration Rule and Proposed Business Conduct Rule. However, ISDA continues to have other concerns with the EDP definition.

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While we acknowledge that the CSA has taken steps to ensure that commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies, we have concerns with the high threshold for a commercial hedger category of EDP at paragraph (n). As noted in Section 4 of this letter, currently there is no hedger threshold in most of Canada, and a much lower Eligible Contract Participant ("ECP") threshold in the U.S. Members of ISDA urge the CSA to delete the financial threshold for commercial hedgers and, failing that, align the EDP and ECP definitions.

In our view, sophisticated entities with less than $10 million in net assets should be eligible to hedge using derivatives as EDPs. At a threshold of $10 million in net assets, it is likely many mid-market entities would not be able to satisfy the asset threshold to qualify as EDPs and would therefore be unfairly prevented from participating in certain derivatives transactions with dealers that opt only to trade with derivatives parties that qualify as EDPs. Absent a clear policy justification for excluding mid-market entities from access to OTC derivatives transactions as qualified EDPs, we believe that either no minimum net asset threshold for commercial hedgers or a lower net asset threshold of $1 million in net assets would be more appropriate for these smaller businesses and will result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSAs policy objectives. Further, many subsidiaries of large multinational corporations, including special purpose entities, may not satisfy the $10 million net asset requirement, which is inconsistent with the ECP requirements. Such subsidiaries are centrally managed by corporate treasury and are generally using derivatives to hedge or mitigate commercial risks. Many such special purpose entities are also intentionally structured to minimize net assets. A lower net asset threshold would help to mitigate these concerns.

With respect to paragraphs (m), (n) and (o) of the definition specifically, as noted in past comments to the CSA, we believe that the requirement for written representations regarding requisite knowledge and experience requirement is unnecessary and may have the unintended effect of disadvantaging sophisticated derivatives parties that currently benefit from participation in the derivatives market. We believe that financial thresholds, which have been widely adopted as the objective standard to assess sophistication in Canadian securities regulation and U.S. securities and derivatives regulation, are appropriate and sufficient to identify derivatives parties who are not in need of extra protections. Whether individuals or not, persons who have sufficient financial resources to purchase professional advice (where necessary or appropriate) or are otherwise financially sophisticated parties can independently assess their risks and make their own judgments regarding their derivatives transactions.

ISDA also remains concerned that, in addition to obtaining written knowledge representations from a derivatives party, the CP would require firms to assess the reasonableness of relying on a derivative party's written representations regarding their knowledge and experience. As we have previously expressed to the CSA, 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 in both the Proposed Registration Rule and Proposed Business Conduct Rule, derivatives firms should be able to rely on those representations absent having any basis or grounds to believe the representations are false. It is unduly burdensome to impose an affirmative obligation on dealers and advisers to assess the reasonableness of representations from counterparties who satisfy the financial thresholds in paragraphs (m), (n) or (o) of the EDP definition.

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Requiring written representations regarding requisite knowledge and experience from derivatives parties and requiring a subjective assessment of those written representations by derivatives firms will impose a significant burden on derivatives firms without any meaningful benefit to derivatives parties. The additional cost and compliance burden may seem minor in isolation, but when combined with derivatives trade reporting requirements, mandatory clearing requirements, margin requirements for uncleared derivatives trades and requirements that may apply under securities law, the cumulative impact on derivatives firms to obtain another written representation from derivatives parties and assess the reasonableness of that representation is unwarranted and onerous. If the CSA has an informed concern, based on an objective assessment of current Canadian derivatives markets, that there is a meaningful population of Canadian persons who meet the financial thresholds in paragraphs (m), (n) or (o) but do not have the requisite knowledge and experience to transact in derivatives, that concern should be specifically explained in future rule proposals subject to public comment so that derivatives firms can consider and respond with proposed solutions to mitigate or address that concern.

ISDA also remains concerned that the EDP definition mostly duplicates other established Canadian definitions, such as "permitted client" in NI 31-103. As ISDA has observed in past comments to the CSA, notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of EDP should include all the persons that qualify as "permitted clients" under NI 31-103. We have previously indicated that 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 Registration Rule and Proposed Business Conduct Rule for any new trades that may be undertaken one year after the Proposed Instrument comes into force. We do not believe that this compliance burden is warranted. If an entity is eligible to participate in the exempt securities market, it stands to reason that it does not need the full set of protections contemplated under the Proposed Business Conduct Rule for non-EDPs. In addition to the adequate investor protection mechanisms in place for permitted clients, it should be re-emphasized that, given that derivatives dealers typically have an ongoing credit relationship with their derivatives counterparties, derivatives dealers indirectly address investor protection concerns as dealers have an extra incentive to appropriately assess and manage risk with their derivatives counterparties.

We have previously observed that, given the existing definitions of "accredited investor" for prospectus disclosures and "permitted client" under NI 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. Also, for derivatives firms that are regulated in other jurisdictions, it is commonly the case that the derivatives firm must confirm whether the derivatives party is an "eligible contract participant" as defined in the CEA.

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 may rely on existing representations and disclosures regarding their clients' "permitted client" and "eligible contract participant" status, a large-scale outreach effort will be required to determine the EDP status of all counterparties to comply with

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the Proposed Registration Rule. We are not aware of any policy reason that would justify imposing such a significant compliance burden on the derivatives markets in Canada. We therefore request that additional paragraphs be added to the definition of EDP to deem any derivatives party that is (i) a "permitted client" as defined in NI 31-103 or (ii) an "eligible contract participant" as defined in the CEA to also be an EDP.

3) Anonymous transactions executed on a derivatives trading facility

We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption?

ISDA welcomes the new exemption proposed by the CSA from certain business conduct requirements if a derivative is traded on a derivatives trading facility (such as a SEF or MTF). However, ISDA does not believe that the exemption should be conditioned on the derivative being cleared. The exemption should apply to derivatives traded on a facility ***or*** cleared (including in respect of the "alpha" trade). This is consistent with the important policy of promoting both derivatives clearing and trade execution on multilateral venues and is consistent with the CFTC's similar exclusion from its business conduct rules. Also, given that derivatives trading facilities and clearing houses have their own rules and compliance requirements that derivatives firms must abide by, ISDA requests that the CSA expand the scope of the exemption to create a complete exemption from Proposed Business Conduct Rule for derivatives traded on derivatives trading facilities, rather than limiting the exemption to the "know your derivatives party" and "content and delivery of transaction information" requirements. ISDA's recommendation that there be an exemption for a derivatives firm from all business conduct requirements in respect of derivatives traded on a derivatives trading facility mirrors the approach taken in most international jurisdictions. ISDA encourages the CSA to consider that there is a need to align Canadian exemptions for transactions executed on a derivatives trading facility with those applied in the U.S. Failure to do so may risk discouraging trading on derivatives trading facilities such as SEFs in contrary to the principles underlying Canada's G20 commitments.

If the CSA is unwilling to expand the scope of the exemption to include all business conduct requirements, we continue to recommend that the existing exemption be expanded to include an exemption from the conflicts of interest requirements in Section 9 of the Proposed Instrument for all anonymous trades. In such instances, it will be impossible for a derivatives firm to determine whether a conflict of interest exists.

We are also considering whether a similar exemption should be available in other scenarios, including, for example:

(a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and

(b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency.

Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

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Yes, it is ISDA's view that similar exemptions should be available in the scenarios listed above, and the exemption should extend to an exemption from all Proposed Business Conduct Rules. See above.

4) Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

The obligations under section 16 should not be expanded to all derivatives parties. In fact, it is ISDA's view that derivatives firms will be incentivized to manage (and indeed, do manage) complaints from all derivatives parties in an appropriate manner in order to preserve their relationships with such derivatives parties. It is likely that transactions with EDPs will be more frequent, and for larger amounts, further incentivizing derivatives firms to promptly respond to complaints. Adding a regulatory requirement for derivatives firms to build formal compliance procedures only adds a further unnecessary administrative and compliance burdens.

5) Derivatives Party Assets

We note that the requirements with respect to initial margin in sections 25 and 26 only apply to transactions with non-EDPs.

Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.

These provisions should be removed from the Proposed Business Conduct Rule and instead added to the Proposed National Instrument 95-401 – *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives*. If the CSA prefers to retain these provisions in the Proposed Business Conduct Rule, entities subject to equivalent requirements under prudential or other rules (for example, *OSFI Guideline E-22 on Margin Requirements for Non-Centrally Cleared Derivatives*) should benefit from substituted compliance.

ISDA further notes that the above proposed adoption of a model of requiring informed consent with respect to the use and investment of initial margin are inappropriate. Clients always have the ability to ask for segregation and to impose any other restrictions. Requiring informed consent will be administratively burdensome.

6) Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have

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relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms. [Staff in British Columbia are particularly concerned about the scope of this requirement, in its current form.]

Naturally, ISDA believes that everyone should conduct business with integrity, however, it is inappropriate to include such a requirement under Section 30(1)(c)(iii) in this rule for three reasons: (i) first, it would be extremely difficult to design compliance procedures around this requirement; (ii) the CSA have already incorporated a requirement for derivatives firms, and individuals acting on behalf of derivatives firms, to act honestly and in good faith which, in ISDA's view, is a more objective and manageable standard; and (iii) similar to the reasons set out with respect to the applicability of complaint handling requirements for EDPs, individuals and derivatives firms are already incentivized to act with integrity in order to attract and maintain business and client relationships. Accordingly, it is ISDA's recommendation that the requirement set out in section 30(1)(c)(iii) be deleted as it is unnecessary and the scope and content of any such requirement is exceedingly uncertain.

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Alberta Securities Commission September 17, 2018
Autorité des marchés financiers
British Columbia Securities Commission
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

Attention:

Me Anne-Marie Beaudoin	Grace Knakowski
Corporate Secretary	Secretary
Autorité des marchés financiers	Ontario Securities Commission
800, square Victoria, 22e étage	20 Queen Street West
C.P. 246, tour de la Bourse	22nd Floor
Montréal, QC H4Z 1G3	Toronto, Ontario M5H 3S8

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Second Notice and Request for Comment – Proposed National Instrument 93-101 – Derivatives: Business Conduct and Proposed Companion Policy 93-101CP - Derivatives: Business Conduct

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OVERVIEW

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the second notice and request for comment published by the Canadian Securities Administrators (**CSA**) titled Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (**NI 93-101**) and Proposed Companion Policy 93-101CP - *Derivatives: Business Conduct* (the **Consultation**).

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The 2017 consultation in respect of then-proposed NI 93-101 is referred to herein as the **2017 Proposal**. All other capitalized terms used in this letter but not defined in this submission have the same meaning given to them in the Consultation.

PMAC represents investment management firms registered to do business in Canada as portfolio managers. PMAC's over 250 members encompass both large and small firms managing total assets in excess of $1.8 trillion for institutional and private client portfolios.

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 elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole.

In light of the many overlapping issues in the two instruments, this submission should be read conjunction with our contemporaneous submission on Proposed National Instrument 93-102 – *Derivatives: Registration* and Proposed Companion Policy 93-102 – *Derivatives: Registration* (**NI 93-102** or the **Registration Consultation**).

GENERAL COMMENTS

Consistent with our submission with respect to the 2017 Proposal, PMAC supports 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 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 counterparties. We also applaud the CSA for developing 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.

PMAC continues to believe that the Consultation and the Registration Consultation are primarily focused on addressing policy issues arising from dealing activities and do not identify specific investor or market protection issues with respect to the activities of advisers, particularly portfolio managers, vis-à-vis derivatives.

In particular, we look to the CSA's anticipated benefits of NI 93-101 and note that, chief among them is a reduced likelihood of loss through inappropriate transactions, inappropriate sale of derivatives and market misconduct. We respectfully disagree with the CSA's assessment in the Consultation that the costs of portfolio managers complying with the proposed derivatives regime are proportionate to the benefits to the Canadian market of implementing NI 93-101 and NI 93-102, as currently drafted.

We strongly believe that the imposition of additional, prescriptive and onerous requirements on portfolio managers is not an effective or efficient solution to the CSA's stated policy concerns with respect to derivatives. For registered advisers, we continue to 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 by leveraging National Instrument 31-103 – *Registration Requirements,*

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Exemptions and Ongoing Registrant Obligations (**NI 31-103**) and by providing an exemption from the derivatives registration and business conduct requirements for portfolio managers, all as more fully set out below and in our response to the Registration Consultation.

Our submission covers the following: 1) a summary of certain of PMAC's key recommendations relating to NI 93-102 and NI 93-101; 2) Consultation Feedback; and 3) responses to certain Consultation questions. The questions are identified by the number assigned to them in the Consultation and, as such, their numbering is not consecutive.

SUMMARY OF PMAC'S KEY RECOMMENDATIONS

1. **Portfolio managers should be exempt from NI 93-101 and from registration under NI 93-102.** As set out in further detail in PMAC's submission with respect to NI 93-102, registered advisers should be entirely exempt from NI 93-101 and from registration as derivatives advisers under NI 93-102, subject to being able to evidence general proficiency and implementing certain risk-management practices relating to derivatives. The rigorous proficiency standards, fiduciary duty of care owed by advisers to their investors, minimum insurance and capital requirements, and the robust, principles-based regime advisers must adhere to under NI 31-103 – coupled with a lack of any policy rationale justifying the need for separate registration and business conduct regimes for advisers - warrants an exemption for portfolio managers.

PMAC has concerns that a Canadian derivatives regime that goes beyond IOSCO's standards and that captures advisers in a way that the U.S. Commodity Futures Trading Commission does not, may have a negative impact on the Canadian derivatives market, as well as on Canadian investors. PMAC respectfully disagrees with the CSA's cost benefit analysis with respect to implementing the derivatives regime for advisers. We note that NI 93-102 and NI 93-101 would require material additional compliance resources and costs and the repapering of existing instruments, client documentation and policies and procedures, all without a demonstrated investor or market harm being addressed. PMAC's submission on NI 93-102 also explores the need for clarity on when advising in derivatives is considered to be "incidental" and sets out certain alternative exemptions for advisers in greater detail.

2. **Exemptions are required for international advisers and sub-advisers.** PMAC believes that exemptions for international advisers and sub-advisers, similar to exemptions set out in NI 31-103, should be included in NI 93-102 and NI 93-102 to ensure competitiveness and to maintain investor choice and market liquidity. PMAC is concerned that there could be unintended adverse consequences to investors and the Canadian market if existing business relationships with foreign advisers were to be interrupted as a result of the implementation of NI 93-102 and NI 93-101.

3. **Eligible Derivatives Parties**. We request that the CSA amend the definition of eligible derivatives party (**EDP**) to include any "permitted client" (as such term is defined in NI 31-103) that is not an individual. We further request that the CSA reconsider the requirement for firms to obtain a written representation from non-individual EDPs as to their "knowledge and experience" to evaluate information about derivatives. As currently drafted, the definition of EDP is not sufficiently harmonized with existing securities law concepts, nor

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does it acknowledge the unnecessary burden that this new, additional definition will impose on firms and the sophisticated clients that it is intended to capture.

4. **Pre-Existing Transactions with EDPs**. PMAC requests that all derivatives transactions with "permitted clients", "accredited counterparties" or "qualified parties" that pre-exist the effective date of NI 93-101 be grandfathered. We believe that these sophisticated clients will not be prejudiced by this approach and that grandfathering all such pre-existing transactions will ease the regulatory burden without any corresponding deleterious impact to markets or EDPs.

In the alternative, should the CSA not be amenable to grandfathering these transactions, we believe that the application all of the EDP requirements should be delayed for such pre-existing transactions for a period of 4 years. We believe that this is an appropriate way to transition firms and these sophisticated clients into the derivatives business conduct requirements, while still allowing these relationships to be renewed and revised in the normal course of business.

5. **Derivatives Party Assets.** We believe that the CSA has yet to provide clarification regarding the intended application of the provisions related to segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client. While these requirements may make sense from a dealer perspective, it is unclear how they apply to a portfolio manager with a fiduciary duty not to commingle client assets.

6. **Senior derivatives manager and reporting requirements**. PMAC is pleased that the CSA made revisions to NI 93-101 to allow the senior derivatives manager to delegate his or her responsibility to submit a report to the board of directors to the firms' Chief Compliance Officer (**CCO**). However, we continue to believe that it is onerous to require firms to hire or designate an additional individual who is tasked with fulfilling substantially the same role as the firm's other registered individuals, such as the Ultimate Designated Person (**UDP**), the Chief Risk Officer (**CRO**) and the CCO. Members are concerned that requirements such as this will negatively impact the competitiveness of the Canadian market and of smaller and mid-sized Canadian firms.

7. **Coordination with other regulatory initiatives and transition matters**. PMAC's submission on NI 93-102 sets out in further detail our request that the CSA assess the impact of the proposed amendments to NI 31-103 (the **Client Focused Reforms**) on the CSA's investor protection and market efficiency concerns, prior to implementing the derivatives registration regime. Other than PMAC's request set out with respect to pre-existing transactions with EDPs, firms have approximated that a three year transition period may suffice for the implementation of many of the amendments necessitated by the derivatives regime.

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CONSULTATION FEEDBACK

Amendments to NI 93-101 since the 2017 Proposal

We would like to start by thanking the CSA for their responsiveness to the comments received as a result of the 2017 Proposal that have been reflected in the Consultation. We view several of these amendments as improving the proposed derivatives business conduct regime for the benefit of investors. In particular, PMAC supports the amendment in the Consultation that allows managed account clients that are EDPs to benefit from the exemptions from certain requirements and protections applicable to other EDPs.

The amendment to NI 93-101 allowing firms to rely on certain pre-existing "permitted client", "accredited counterparty" or "qualified party" representations as set out in Section 45 of NI 93-101 in order to determine EDP status during the transition period, is a welcome starting point. PMAC requests that, all derivatives transactions with "permitted clients", "accredited counterparties" or "qualified parties" pre-existing the effective date of NI 93-101 be grandfathered. We believe that these sophisticated clients will not be prejudiced by this approach and that grandfathering all such pre-existing transactions will ease the regulatory burden without any corresponding deleterious impact to markets or EDPs.

In the alternative, should the CSA not be amenable to grandfathering these transactions, we believe that the application all of the EDP requirements should be delayed for such pre-existing transactions for a period of 4 years. We believe that this is an appropriate way to transition firms and these sophisticated clients into the derivatives business conduct requirements, while still allowing these relationships to be renewed and revised in the normal course of business.

International Standards and the robust Canadian regulation of advisers

The substance and purpose of NI 93-101, as explained by the CSA in the Consultation, is to develop an instrument to protect investors, reduce risk, and improve transparency and accountability in the OTC derivatives market. The Consultation is also a response to IOSCO's concerns about the contribution to the financial crisis of 2008 by some firms dealing in derivatives as a result of not effectively managing their own derivatives-related risks. Importantly, NI 93-102 references IOSCO's comments that:

> Historically, market participants in the OTC derivatives markets have, in many cases not been subject to the same level of regulation as participants in the traditional securities market. This lack of sufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008. [emphasis added]

PMAC believes that portfolio managers are already robustly regulated and overseen by members of the CSA under NI 31-103 and that the creation of a parallel - but not identical - regulatory regime to oversee this category of registrants is not warranted to address IOSCO's OTC derivatives market concerns.

We believe the CSA has approached the Consultation from the point of view that advisers must be regulated in the same way as dealers in order to satisfy Canada's IOSCO

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obligations with respect to OTC derivatives. PMAC feels that this approach does not adequately account for unique circumstances regarding the regulation of portfolio management firms. These factors include the rigorous proficiency requirements required of advisers, the fiduciary duty of care owed by advisers to their investors, minimum insurance and capital requirements, and the robust, principles-based regime that advisers must adhere to under NI 31-103. We believe these factors warrant the exclusion of portfolio managers from the application of NI 93-101.

Concerns regarding applicability of NI 93-101 to portfolio managers

Despite the amendments to NI 93-101 and the publication of the Registration Consultation, PMAC continues to believe that a compelling policy rationale for requiring separate market conduct and registration rules for advisers with respect to derivatives has not been adequately articulated. We respectfully disagree with the CSA's response to the 2017 Proposal that the proposed business conduct regime for derivatives advisers does not unnecessarily duplicate certain requirements under NI 31-103 for portfolio managers.

We do not believe that investors or the Canadian capital markets will benefit from the CSA imposing duplicative and additional market conduct requirements on advisers in the derivatives context.

Application of NI 93-102 to foreign firms

One of PMAC's key concerns with respect to NI 93-101 and NI 93-102 arises in connection with 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 under the Registration Consultation and be required to comply with the requirements proposed in NI 93-101 by virtue of tripping over the business trigger. In setting out the anticipated costs and benefits of NI 93-102, the CSA note:

> There is a possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with [NI 93-102], which would reduce Canadian derivatives parties' options from derivatives services. However, [NI 93-102] contemplates a number of exemptions, including exemptions for smaller derivatives dealers that only deal with eligible derivatives parties and for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent requirements for foreign firms. These exemptions could significantly reduce compliance costs associated with [NI 93-102] for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

Members are concerned about the impact on end investors should the complexity, filing burden and/or cost of the Canadian derivatives regime deter international participation in our markets.

Canadian rules with respect to derivatives, should account for our reliance on foreign markets for liquidity and access to foreign advisers in order to achieve a balance of interests. PMAC has concerns regarding the proposed requirement that foreign derivatives firms that are exempt from registration under equivalent foreign or domestic regulations

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would nonetheless be required to be registered in Canada under NI 93-102 and be required to comply with NI 93-101. We continue to strongly urge the CSA to extend certain aspects of the international adviser exemption in Section 8.26 of NI 31-103 as well as the international sub-adviser exemption set out in subsection 8.26.1 of NI 31-103 in both NI 93-101 and NI 93-102 so that existing business relationships and access to investments for firms' clients will not be disrupted.

We understand that the CSA wishes to limit the exemption from the registration requirement to firms that are "registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix G" of NI 93-102 (**Appendix G**). PMAC believes that, if the CSA is prepared to rely on the substituted compliance of those foreign jurisdictions for firms that must be regulated, it also follows that the exemptions from derivatives regulation that those jurisdictions have approved should similarly be valid exemptions for the purposes of NI 93-101 and NI 93-102.

Further, PMAC is not aware of other jurisdictions that have registration regimes applicable to derivatives advisers in respect of OTC derivatives transactions, so substituted compliance as currently contemplated will not be meaningful. For this reason, we recommend that an exemption from the registration and business conduct requirements also be available where a foreign derivatives adviser is not required to be registered in its home jurisdiction to advise in respect of derivatives, if that foreign derivatives adviser is registered, or exempt from registration, under its home jurisdiction's securities legislation.

We believe that the CSA can concurrently take a meaningful and principles-based approach to addressing the issue of substituted compliance while, at the same time, avoiding implementing measures that would unnecessarily disrupt cross-border trade flows. Certain members have suggested that one way of achieving a more principles-based assessment of substituted compliance would be to permit IOSCO member jurisdictions that have implemented IOSCO's recommendations in this respect to automatically be included in the CSA's substituted compliance regime.

If the CSA's derivatives regime is implemented without a workable exemption for international advisers, members have voiced concerns that Canadian firms may be unable to attract and hire top international talent for their investors since international advisers may be deterred from participating in the Canadian market without an exemption. We also note that the Canadian registered firm would continue to be – as is currently the case under subsection 8.26.1(1)(b) of NI 31-103 – responsible for any loss that arises out of the failure of the international sub-adviser and that the sub-adviser would be subject to the Canadian registered firm's initial and on-going due diligence, if an exemption similar to section 8.26.1 of NI 31-103 is included in NI 93-102 and NI 93-101.

While PMAC strongly recommends that the CSA not adopt the proposed substituted compliance concept in the derivatives regime, we understand that Appendix G will be completed and published for comment under separate cover once the CSA has completed an equivalency analysis. We believe that, in order to respond to evolving regulatory regimes, the CSA should develop a way that would permit the efficient evaluation and addition of new

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jurisdictions to the list of acceptable substituted compliance jurisdictions under Appendix G, as opposed to risking a static list that could become outdated.

Members have also raised concerns about the increased costs to Canadian dealers that provide their services to Canadian portfolio managers. Such Canadian dealers may not only experience increased costs directly as a result of proposed NI 93-101 and NI 93-102, but may also experience increased costs indirectly as a result of having fewer international dealers to deal with, should there be significant foreign dealer exits from Canada. Such costs at the dealer level could have the unintended negative consequence of wider spreads and a drag on investment returns for Canadians.

Senior derivatives manager and reporting requirements

PMAC is pleased that the CSA made revisions to NI 93-101 to allow the senior derivatives manager to delegate his or her responsibility to submit a report to the board of directors to the firms' CCO. PMAC believes that this ability makes sense from a compliance oversight standpoint, and is also reflective of the business reality that boards prefer to deal with a set number of known and trusted executives.

We believe that the requirement for the derivatives UDP to report to the board of directors of a firm in the circumstances set out in Subsection 27(3)(c) of NI 93-102 is duplicative of the requirement for the senior derivatives manager (or, if delegated, the CCO) to report to the board in the circumstances set out in Subsection 31(2) of NI 93-101 and as elaborated on in the Proposed Companion Policy to NI 93-101. We believe that deleting the requirement in Subsection 27(3)(c) of NI 93-102 would clarify the reporting obligations without creating a duplicative burden that does not bolster the compliance function.

We also refer the CSA to PMAC's submission on the Registration Consultation where we highlight a number of comments and concerns surrounding the roles and responsibilities of the senior derivatives manager, UDP, CCO and CRO and pose a number of questions about the responsibility of and interplay between these various roles.

Overall, we continue to believe that the requirement to hire or designate a senior derivatives manager is onerous and unnecessary. We urge the CSA to simplify and streamline personnel and reporting requirements and believe that failure to do so could negatively impact the competitiveness of Canada's market and of our firms, without a corresponding market or investor protection benefit.

RESPONSES TO SPECIFIC CONSULTATION QUESTIONS

> 2. ***Definition of "eligible derivatives party".*** *Are the criteria in paragraphs (m), (n) and (o) appropriate?*

While PMAC had hoped the CSA would leverage the existing "permitted client" definition instead of introducing a new category of sophisticated investor, given the CSA's decision to continue with the definition of EDP, we encourage as much consistency as possible between NI 31-103, NI 93-101 and NI 93-102 based on the philosophy of these being parallel regulatory regimes and in order to avoid confusion and complexity. As such, we request

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that the CSA amend the definition of EDP to include any non-individual person that is a "permitted client", as such term is defined in NI 31-103.

While PMAC believes the criteria in subsection (n) of the EDP definition are an appropriate way for the CSA to harmonize EDP with the "accredited counterparty" category under the *Derivatives Act* (Quebec). However, members have noted concerns, however, that such criteria remains insufficiently harmonized with the "eligible contract participant" category under the U.S. Commodity Exchange Act. We believe it is crucial to ensure as much harmonization as possible.

We note that, as proposed, NI 93-101 and NI 93-102 will require many firms to potentially grapple with four different sophisticated investor definitions: "accredited investor", "permitted client", "qualified party" and EDP. This is not only overly cumbersome for firms, but it is likely to be frustrating for investors who will be required to complete all the resultant paperwork. We continue to believe that this additional complexity is unwarranted.

PMAC further asks the CSA to reconsider the requirement for firms to obtain a written representation of an institutional EDP's "knowledge and experience" to evaluate information about derivatives. For institutional EDPs, the requirement to obtain such a representation only creates regulatory burden without corresponding risk reduction or investor protection benefits. Institutional EDPs do not require these additional protections and have the resources and the expectation that they will contractually negotiate their own commercial arrangements with derivatives advisers.

> *5.* ***Derivatives Party Assets.*** *[…] Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.*

PMAC believes that it would be appropriate to adopt an informed consent model.

We believe that the CSA has yet to provide clarification regarding the intended application of the provisions related to segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client. While these provisions may make sense from a dealer's perspective, it is unclear how they would apply to a portfolio manager with a fiduciary duty not to commingle client assets.

CONCLUDING COMMENTS

We would like to thank the CSA for the work, thought and outreach that has gone into developing and publishing this Consultation as well as the Registration Consultation.

We continue to believe that it is of utmost importance for the CSA not to impose one-size-fits-all rules on portfolio managers and that, instead, investors and the market are better served by leveraging more principles-based regulation that recognizes the already robust regulatory requirements and legal duty of care these professionals owe their clients.

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We would be happy to speak with you further about any of the remarks in our letter and/or in our submission on the Registration Consultation.

We look forward to continuing our dialogue with the CSA on these matters at the up-coming OSC Roundtable on Derivatives.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

Katie Walmsley
President
Portfolio Management Association
of Canada

Margaret Gunawan
Managing Director – Head of Canada Legal
& Compliance
BlackRock Asset Management Canada
Limited

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DATE: September 17, 2018

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

Grace Knakowski, Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
Via Email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Via Email: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct*, Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, Proposed National Instrument 93-102 *Derivatives: Registration*, and Proposed Companion Policy 93-102CP *Derivatives: Registration*

We are writing in response to the request for comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct*, ("**NI 93-101**") Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, ("**CP 93-101**"), Proposed National Instrument 93-102 *Derivatives: Registration*, ("**NI 93-102**") and Proposed Companion Policy 93-102CP *Derivatives: Registration* ("**CP 93-102**"). In our comments below, we have referred to NI 93-101 and CP 93-101 collectively as the "**Business Conduct Rule**" and to NI 93-102 and CP 93-102 collectively as the "**Registration Rule**".

ATB Financial is a full service, deposit-taking financial institution located in the Province of Alberta. We are a crown corporation, owned by the Province of Alberta. Pursuant to the *ATB Financial Act* (Alberta) we are also an agent of the Province of Alberta for all purposes. With assets of more than $51.9 billion, we are the largest Alberta-based financial institution. Our operations include a full-service financial markets group focused on foreign exchange, interest rates, and commodity transactions and this has informed our perspective. We appreciate the opportunity to comment on the proposed instruments and are supportive of the regulatory steps to harmonize derivative practices.

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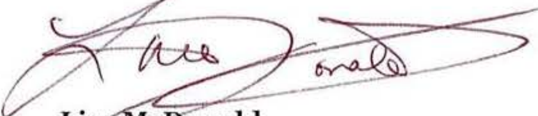
ATB atb.com

We consent to the disclosure of our submission in whole as part of a non-attributed summary of comments that requires that our identity and any personal identifiers be removed prior to publication.

Yours Truly,



Lisa McDonald
Chief Risk Officer
Risk Management

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Part A: Business Conduct Rule

In your request for comment on the Business Conduct Rule, you have asked commenters for feedback on specific questions, in addition to providing general comments. We will begin with our comments on the specific questions listed in the request for comment:

1) Definition of "affiliated entity".

We do not have a strong preference between defining affiliated entities based on control versus consolidation of accounts. However, we believe that the harmonization of these definitions across related rules will provide clarity to the industry, as having similar (or identical) terms with different definitions, in related rules is likely to lead to confusion among industry participants.

2) Definition of "eligible derivatives party"

We believe that the definition of this term should be aligned with the definition of "qualified party" contained in the various blanket orders issued by securities regulators (for example, Alberta Securities Commission Blanket Order 91-507). Our rationale is that the latter definition has proven to be well understood by market participants and has been effective in ensuring derivative parties are receiving appropriate protection.

Therefore, we suggest that the reference to '$25,000,000 in net assets' in sub-section (m) be amended to refer to 'total assets' (instead of net assets) and that the reference to '$5,000,000' in sub-section (o)(ii) simply refer to 'net assets'.

While we believe the various requirements in (m)(i), (n)(i), and (o)(i) are reasonable, we would also suggest it be clarified that a derivatives party can also meet those requirements by obtaining external advice, should they not have the required expertise 'in-house'.

3) Anonymous transactions executed on a derivatives trading facility

We would support an expansion of the exemption in section 41 of NI 93-101 to cover all situations where a derivatives firm is expected to provide documentation to a derivatives party. For example, section 28 obligates a derivatives firm to provide quarterly statements to a derivatives party. However, in the case of a transaction that has been accepted for clearing by a qualified clearing agency, the derivatives firm is no longer the derivative party's counterparty for the transaction, and therefore we do not believe it is appropriate to have the section 28 requirements continue to apply. As such, we would support the expansion of these exemptions to all cases where derivatives are submitted for clearing to a regulated clearing agency.

4) Handling complaints

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We do not believe the obligations in section 16 should be expanded towards all derivative parties. We believe that eligible derivative parties are sophisticated enough to be able to resolve complaints with derivative firms without needing regulatory intervention.
Furthermore, we also note that, on its face, section 16 is not limited to complaints about the derivative firm's derivative operations. In the case of derivative firms that have significant other operations (such as financial institutions) the effect of this rule appears to be to regulate those other operations as well. Therefore, we suggest this section be amended to specifically refer to complaints about the firm's derivative operations only.

5) Derivatives Party Assets

We do not believe the requirements in sections 25 and 26 of NI 93-101, which deal with the appropriate model for protecting customer assets of derivatives parties, should apply to all derivative parties. We do not believe these protections are required by eligible derivative parties. We also note that other regulations may impose restrictions on collateral, and we would discourage the practice of having the same topic dealt with in multiple, potentially overlapping, regulations.

6) Policies, procedures and controls

Our only comments on section 30(1)(c)(iii) of NI 93-101 are that we would expect most derivative firms to rely primarily on a company-wide code of conduct or similar document requiring all employees to act with integrity. It may be helpful to clarify in CP 93-101 that such a document may be relied upon, at least in part, to provide the reasonable assurance required by section 30. We also note that section 30(1)(c)(iii) is not expressly limited to acting with integrity with respect to the firms derivative activities. While an employee's actions, that are unrelated to the firm's derivative activity, may be of concern to the firm, as employer, we do not believe regulatory intervention would be appropriate in such a case, provided that such actions do not impact the firm's derivative operations.

General Comments on the Business Conduct Rule:

In addition to the above, we have the following comments on the Business Conduct Rule:

1. The definition of "Canadian financial institution" includes, among other things, a 'treasury branch'. ATB Financial was formerly known as Alberta Treasury Branches prior to our name change in December 2017. We believe the reference to a 'treasury branch' in the definition of Canadian financial institution operates to include ATB Financial.

   While we believe that interpretation is still accurate, given our name change, and for the sake of clarity, we would request that the definition of Canadian financial institution be amended to include a reference to 'financial institutions'. This will help to clarify that ATB Financial continues to be included in that term.

2. We believe that certain requirements applicable to trades with non-eligible derivative parties may have an unintended consequence of reducing the willingness of derivative firms to transact with

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non-eligible derivative parties, rather than providing those non-eligible derivative parties with the intended increased protection.

For example, the suitability requirement in section 12 requires, in part, that a derivatives firm take reasonable steps to ensure that a derivative and a transaction are suitable for a derivatives party before the firm accepts instructions to transact in the derivative. However, current practice is for derivative firms to expressly obtain representations from their counterparties that the counterparty is capable of making, and has made, its own suitability assessment. We believe this practice reflects the fact that, in the derivatives area, the derivatives firm and its counterparty take the opposite sides of a transaction.

We also note the tied selling obligation listed in section 18 of NI 93-101, which prohibits a derivatives firm from requiring a person obtain a product or service from the derivatives firm as a condition of obtaining another product or service. CP N3-101 makes clear that the intent of this rule is that a derivatives firm, that is also a lender to a person, cannot require that the person hedge their exposure under the loan with the derivatives firm. The obligation to engage in derivatives may be required in borrower-specific circumstances as a risk mitigation tool and as a matter of practice, firms will typically engage in those derivatives with the lending financial institution as a means to manage fees and administration associated with the borrowing arrangement. Even where it is not explicitly stated, a borrower may practically find it difficult to enter into a hedge with another entity, at least without incurring additional costs, given that the borrower has likely already granted the lender with security as part of the lending relationship.

We refer to our comment above about aligning the definition of eligible derivatives party with the definition of a qualified party currently used in various blanket orders. However, an alternative suggestion would be to permit non-eligible derivative parties to qualify as eligible derivative parties by obtaining the services of a registered derivatives advisor. Through regulations applicable to the derivatives advisor, regulators could ensure that these parties are receiving any protection that is required, including being provided with necessary disclosures, while avoiding the potential issues outlined above.

3. As a practical consideration, on occasion, derivative parties will request to enter into a transaction with a derivative firm before a 'master agreement' has been executed between the parties. Typically, the practice is that pricing and other trade-specific terms are discussed between the parties, but more general terms, such as events of default, are not. Those more general terms are typically contained in the trade confirmation exchanged between the parties (often by way of the parties being deemed to have entered into a 'master agreement' pending the actual execution of one), as required by section 27(1).

   However, it is unclear whether such a practice would violate section 33. We suggest this be clarified by specifying that the requirements in section 33 can be met by way of the confirmation required to be delivered under section 27(1).

4. We note that section 45(3)(b) provides an exception for pre-existing transactions, so long as the derivative firm has taken reasonable steps to determine that their counterparty meets one of the listed definitions. We suggest that the threshold for 'reasonable steps' be clarified to include

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receiving a written representation, and having no reason to question the accuracy of that representation.

Finally, we understand that Appendix C, which will list any requirements that do not apply to a Canadian Financial Institution, is scheduled to be released at some future point. As such, our comments are subject to further review of that document.

Part B: Registration Rule

We note that Section 5(c) of the Registration Rule exempts crown corporations or agencies, if their accounts are 'consolidated for accounting purposes' with those of the federal or a provincial government.

As noted in our opening comments, ATB Financial is a crown corporation, owned by the Province of Alberta, as well as an agent of the Province. As ATB Financial's overall financial results (including, but not limited to, results from our derivative trading activity) are consolidated in the Alberta provincial government's annual financial reporting, we therefore believe ATB Financial would be included in the exemption under Section 5(c). As a result, we have refrained from providing comments on the Registration Rule.

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BLACKROCK®

September 17, 2018

Submitted via electronic filing: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

Alberta Securities Commission
Autorité des marches 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

Attention:

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, QC H4Z 1G3

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Re: Canadian Securities Administrators Notice and Second Request for Comment – Proposed National Instrument 93-101 – *Derivatives: Business Conduct* and related Companion Policy 93-101CP (together, "Proposed Business Conduct Rule")

Dear Me Beaudoin and Ms. Knakowski:

A. About BlackRock

BlackRock Asset Management Canada Limited ("**BlackRock Canada**") is an indirect, wholly-owned subsidiary of BlackRock, Inc. (together with BlackRock Canada, "**BlackRock**" or **"we"**) and is registered as a portfolio manager, investment fund manager and exempt market dealer in all jurisdictions of Canada, a commodity trading manager in Ontario, and an adviser under *The Commodity Futures Act* (Manitoba).

BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. As an investment adviser, we embrace our role as a fiduciary to our clients and recognize its importance in protecting investors.

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B. General Observations

BlackRock supports the Canadian Securities Administrators' ("**CSA**") ongoing efforts "to protect investors, reduce risk, improve transparency, increase accountability and promote responsible business conduct in the over-the-counter (OTC) derivatives markets"[1]. However, we respectfully caution that some elements of the Proposed Business Conduct Rule (and particularly when combined with all the requirements contemplated under Proposed National Instrument 93-102 and Proposed Companion Policy 93-102CP – *Derivatives: Registration* (the **"Proposed Registration Rule"**)), will be disproportionately burdensome when weighed against the CSA's stated policy objective. For instance, registered advisers are already subject to significant securities market regulation and oversight and the CSA itself acknowledges that it is introducing the Proposed Business Conduct Rule and Proposed Registration Rule to meet its commitments "to create a *derivatives dealer regime* [emphasis added] that is also consistent with the regulatory approach taken by most IOSCO jurisdictions with active derivatives markets."[2] In our experience, asset managers such as BlackRock have established robust compliance and risk management programs applicable to their entire business and would not generally differentiate between asset classes in implementing and maintaining such programs. In addition, our fiduciary obligation as a registered adviser is paramount in the way we conduct ourselves vis-à-vis our clients. It is our view that any conduct standards to be imposed by the Proposed Business Conduct Rule already substantively exists in other regulations and is also embedded in a portfolio manager's fiduciary duty. Therefore, there would be no incremental, meaningful protection for clients in imposing another layer of business conduct requirements in the context of OTC derivatives.

As a general principle, we support initiatives that encourage long-term savings by improving the quality of advice, better aligning interests of registrants with those of their clients, and broadening the choice of investments and services offered to investors. The potential costs and resources associated with meeting the requirements under the Proposed Business Conduct Rule, which in some case are duplicative of, and lacking harmonization with, other Canadian and global regulations, outweigh the anticipated benefits. The exemptions provided may not be sufficient to incent some derivatives firms to enter or remain in the Canadian market. The real impact of this would be felt by Canadian investors if competition in the market is reduced, leading to an increase in spreads and other costs without a corresponding material benefit such as protecting investors from undue risk. This is especially true when assessing against the conduct of registered advisers.

Beyond these general observations, our specific feedback on the Proposed Business Conduct Rule is set out below. All capitalized terms used in this letter but not defined herein have the same meaning given to them in the Proposed Business Conduct Rule. We have also provided comments on the Proposed Registration Rule, which should be read together with this submission.

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[1] (2018), 41 OSC 4804.

[2] (2018), 41 OSC 4804.

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C. BlackRock's Responses

Applicability/scope of the Proposed Business Conduct Rule to registered advisers

Similar to the views expressed in our submission about the Proposed Registration Rule, BlackRock is concerned about the lack of an exemption under the Proposed Business Conduct Rule for firms already registered as an adviser (i.e. portfolio manager) and that as currently contemplated, the scope of the Proposed Business Conduct Rule is too broad. Although certain business conduct obligations do not apply if a derivatives adviser is advising an "eligible derivatives party" (**"EDP"**), other obligations such as the fair dealing, managing conflicts of interest, and know-your-derivatives party requirements[3] would continue to apply--these concepts are already sufficiently covered under other regulation such as National Instrument 31-103 – *Registration Requirements, Exemptions, and Ongoing Registrant Obligations* (**"NI 31-103"**). It is unclear what requirements in the Proposed Business Conduct Rule are not substantially being carried out by registered portfolio managers pursuant to existing rules, or what requirements are missing from NI 31-103 or other rules which are of concern to the CSA. We respectfully submit that there should be an explicit provision in the national instrument, or alternatively, explicit guidance in the companion policy that, to the extent portfolio managers are already complying with the applicable requirements under NI 31-103, then they are deemed to have complied with the applicable requirements under the Proposed Business Conduct Rule.

In addition, portfolio managers owe a fiduciary duty to their clients. This fiduciary duty and the robust requirements of NI 31-103 govern the conduct of registered advisers and should be sufficient to meet, and in many cases, exceed the minimum business conduct standards being proposed.

Finally, in reading the Proposed Business Conduct Rule and Proposed Registration Rule together, there is no clear policy rationale for Canadian regulated financial institutions to benefit from exemptions while registered portfolio managers do not.

Senior derivatives managers

The requirement to appoint one or more senior derivatives managers to be responsible for supervising the derivatives-related activities of derivatives business units to ensure compliance with securities laws, as well as to respond to any material non-compliance is unduly onerous and does not align with existing derivatives regulation globally[4]. Registered portfolio managers must operate a compliance program under NI 31-103. The ultimate designed person and chief compliance officer, with the support of other senior personnel, are registered individuals already responsible for ensuring compliance with securities laws. In addition, there is an extensive

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[3] For instance, section 2.1 of OSC Rule 31-505 – *Conditions of Registration* and equivalent rules or regulations in other Canadian jurisdictions (fair dealing), section 13.4 of NI 31-103 (identifying and responding to conflicts of interest), as may be amended by the proposed amendments recently published (the **"Client Focused Reforms"**), and section 13.2 of NI 31-103 (know-your-client), as may be amended by the Client Focused Reforms.

[4] We note, for example, that the senior managers regime in the UK is applicable more broadly to entities registered with the Financial Conduct Authority (**"FCA"**) and does not purport to only apply to derivatives activities of FCA registered investment managers.

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framework around the registration of other individuals conducting registrable activities such as portfolio management under NI 31-103, including ongoing obligations in order to maintain one's registration in good standing. We question why, in the narrower context of OTC derivatives, the CSA is imposing similar obligations to unregistered individuals. The proposed responsibilities of the senior derivatives manager should be subsumed under NI 31-103, including any reporting to the derivative adviser's board of directors and, if applicable, to the CSA[5]. Otherwise, one of the unintended consequences may be smaller domestic and foreign firms deciding not to establish or continue supporting Canadian clients and the Canadian OTC markets.

Applicability/scope of the Proposed Business Conduct Rule to foreign registered (or exempt) advisers

The exemptions available under the Proposed Business Conduct Rule to foreign advisers are predicated on a "substituted compliance" requirement in the foreign advisers' home jurisdiction. It is difficult to comment on this requirement when the permitted jurisdictions and regulations have yet to be published. Hopefully, the jurisdictions qualifying for the substituted compliance regime will, at a minimum, be the same under both the Proposed Business Conduct Rule and the Proposed Registration Rule. Moreover, BlackRock questions the usefulness of introducing a different exemption framework for OTC derivatives from what is currently available under NI 31-103 for the securities market. It is not appropriate that foreign advisers who are registered or rely on an exemption in a foreign jurisdiction would need to comply with even some of the requirements of the Proposed Business Conduct Rule. Hence, we urge the CSA, for the reasons outlined in our submission on the Proposed Registration Rule, to adopt the international adviser and international sub-adviser exemptions currently available under NI 31-103.

Content and delivery of transaction information – section 27(1)

Paragraph 27(1)(b) requires a derivatives dealer to provide a written confirmation to the derivatives party, or if the derivatives party consents or has given a direction in writing, to the derivatives adviser acting on behalf of the derivatives party. Advisers typically handle all trading documentation for clients, including reviewing derivative transaction confirmations. Such authority is typically granted in investment management agreements. Market practice today is for a derivatives dealer to provide the confirmation to the derivatives adviser as agent for the derivatives party. In lieu of including 27(1)(b), we would respectfully suggest the language in 27(1)(a) be changed to read "if the derivatives party or its authorized agent(s) consents...". We think this would achieve the policy objective of requiring the derivatives dealer to provide a confirmation for every trade, while being consistent with existing market practice and without creating any ambiguity regarding whether a new, separate written direction from a derivatives party is required.

Derivatives party assets – Division 2

BlackRock has two comments on Part 4, Division 2 of the Proposed Business Conduct Rule. First, the subject matter of this division (i.e. margin and collateral requirements) is misplaced

[5] Please refer to our comments regarding the roles and responsibilities of the derivatives UDP, CCO and CRO in our submission on the Proposed Registration Rule.

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within a rule governing business conduct and is more appropriately included in Proposed National Instrument 95-401 - *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives.*

Second, BlackRock believes that these provisions only make sense as applied to a derivatives dealer. To the extent there is a concern that a registered adviser would, for example, commingle the assets of separate clients, such activity would already be contrary to an adviser's fiduciary duty. If the CSA does not move these provisions from the Proposed Business Conduct Rule, we would suggest modifying Division 2 to apply only to derivatives dealers.

Policies, procedures and controls related to integrity

The requirement to have policies, procedures and controls that are sufficient to assure that an individual who advises on derivatives on behalf of a derivatives adviser conducts themselves with integrity specifically, is unnecessary. A registered adviser would already have these documents and controls in place given the requirements in NI 31-103 to establish and maintain policies and procedures to ensure compliance with securities legislation. Moreover, to be registered as an advising representative, an individual typically must have his or her Chartered Financial Analyst designation. As a result, these individuals must already abide by the CFA Institute of Code of Ethics and Standards of Professional Conduct which incorporates integrity as one of its central principles.

Furthermore, as discussed above, registered portfolio managers must already abide by a fiduciary duty to act in the best interests of the client and this is the highest integrity standard applicable. To the extent that there are residual policy concerns in the context of OTC derivatives, amendments to NI 31-103 would be a better approach and that consideration by the CSA should be made as to whether the current client focus reform proposals sufficiently address these residual policy concerns.

Transition Period

The Proposed Business Conduct Rule and the Proposed Registration Rule should come into force concurrently, given both are intended to be the comprehensive regime for the regulation of OTC derivatives. Further, as noted previously, under both sets of proposals, the relevant appendices for exemptions available to foreign derivatives advisers have not been published for comment. As noted in our submission on the Proposed Registration Rule, a process for maintaining the list of acceptable foreign jurisdictions in Appendix G should also be established and released for public comment. It will be very inefficient and disruptive to implement one set of rules, then the other. The transition period should be a minimum of 3 years from the coming into force of both rules in order to provide sufficient time for the industry to implement the numerous new obligations.

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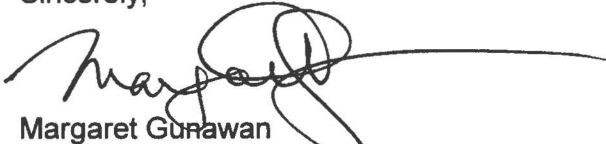
D. Conclusion

BlackRock appreciates the opportunity to provide input on this important regulatory initiative and would be pleased to make appropriate representatives available to discuss any of these comments with you.

Sincerely,



Margaret Gunawan
Chief Compliance Officer and Secretary, BlackRock Asset Management Canada Limited

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17 September 2018

BC Securities Commission

To whom it may concern,

Please accept these comments with regards to the proposed OTC derivatives National Instruments 93-101 and 93-102.

NI 93-101 Derivatives: Business Conduct

Part 4 Division 1, 20. (1) Daily reporting

On each business day, a derivatives dealer must make available to a derivatives party a valuation for each derivative…

Our corporate FX clients deliver on their forward and option hedges. They rarely close them out. They only buy USD forward for example because they have USD accounts payable in the coming months. For instance, they will book a 3-month forward buying USD at 1.3150 today and they may start pre-delivering against that contract at 1.3150 in a few days or weeks. By the value date of the contract it will be fully drawn down. The marked-to-market (MTM) value of the forward is of no significance to the client. They have locked in a rate (1.3150) to protect the cost of their USD payables and they don't care what the MTM value of that forward is. They will deliver against it rather than selling it back to the market.

Same goes for options, whether vanilla calls and puts or structured zero-cash options. What matters to clients is their protection rate and their participation rate. These are the rates they may or may have to deliver or take delivery of USD at. The MTM value of the contract has no meaning in our deliverable FX business.

The MTM value of a FX forward or option would only be of interest to a speculator, not a commercial hedger who is actually going to deliver against the contract. Our clients use forwards and options to reduce FX rate uncertainty, not to beat the market. We encourage them to hedge systematically on a rolling 12-month basis, for example, and not try to time the market. Whether the hedge is in-the-money or out-of-the money once it is booked is irrelevant and could mislead our clients if we report it to them on a daily basis. What's important to FX hedging clients is the actual rates they'll be delivering or receiving USD at over their hedging horizon.

NI 93-102 Derivatives: Registration

Page 3281 Part 5 Division 1 18 (2) (b) (i)

"the individual has worked at a registered securities firm, at a derivatives dealer…"

Does "registered" apply to the derivatives dealer or just securities firm? Assume it does not apply to derivatives dealer since a registered derivatives dealer has not existed in Canada to date.
An individual who meets the requirements in 18 (2) (b) and has been employed at a non-registered derivatives dealer for 5 years, including 36 months in a compliance capacity, would qualify as a chief compliance officer?

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Same applies to chief risk officer qualifications. We have lots of senior people that have worked their entire career in at non-registered FX firms offering derivatives. Is that experience being recognized for registration purposes?

Page 3282 Part 5 Division 1 18 (4) (b)

"the individual has passed the Futures Licensing Course Exam and the National Commodities Futures Exam"

As a non-bank FX dealer, we only offer OTC FX forwards and options. We do not sell exchange listed futures. Since starting EncoreFX in 2015, we have required all our dealers to pass the CSI Derivatives Fundamentals and Options Licensing course (DFOL). We looked at all the courses available through CSI and determined that the DFOL was the best fit for our OTC FX business. The options licensing course is considerably more relevant to our business than the futures licensing course. We utilize options a lot in client hedging strategies, never futures.

Page 3282 Part 5 Division 1 18 (6) (a)

"the individual has earned a CFA Charter and has gained 12 months of relevant investment management experience, including experience relating to derivatives…"

We have CFA charter holders who have worked their entire career in the FX risk management business offering hedging advice to corporate clients. They have never worked in the investment industry but have years of FX hedging experience. Will that experience count under 18 (6) (a) or do they have to have investment management experience?

Page 3282 Part 5 Division 1 18 (6) (b) (i)

We have FX hedging experts on staff with years of experience helping businesses manage their FX risks. For dealers wanting to upgrade their credentials beyond the DFOL, but the CFA program is not a viable option, we encourage them to attain the CSI Certificate in Derivatives Market Strategies. The company pays for this program. We believe this program is a much better fit for our risk management oriented dealers than the investment industry CIM. Hedging and risk management are similar to the investment industry in some respects but it is really a very different vocation. Our dealers are trained to help business clients reduce market risk through prudent hedging strategies. That requires a different knowledge set and expertise than investment management. Many of our dealers are well on their way to attaining the Certificate in Derivatives Market Strategies. It should be recognized for purposes of qualifying as a derivatives adviser along with the CIM.

Sincerely,

ENCOREFX INC.
Paul Lennox, CFA
President

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September 17, 2018

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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

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Grace Knakowski
Secretary
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Toronto, Ontario M5H 3S8
comments@osc.on.gov.ca

Dear Sirs/Madams:

Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy / Proposed National Instrument 93-102 *Derivatives: Registration* 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* **(Proposed Business Conduct Rule)**; and

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

(collectively, Proposed Business Conduct Instrument).

Proposed National Instrument 93-102 *Derivatives: Registration* **(Proposed Registration Rule)**; and

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Proposed Companion Policy 93-102 *Derivatives: Registration* **(Proposed Registration CP)**.

(collectively, Proposed Registration Instrument).

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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Calgary, AB T3G 3S9
james.hawkins@cenovus.com

Priscilla Bunke
PetroChina International (Canada) Trading Ltd.
Suite 1800, 111-5th Avenue SW
Calgary, AB T2P 3Y6
priscilla.bunke@petrochina-ca.com

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 Business Conduct Instrument for comment. On June 14, 2018, the CSA republished the Proposed Instrument for a second request for comment. Also on April 19, 2018 the CSA published the Proposed Registration Instrument for comment. The IECA strongly believes that the Proposed Business Conduct Instrument and the Proposed Registration Instrument should continue to be moved forward in unison. The IECA is grateful for the opportunity to submit supplementary comments on the Proposed Business Conduct Instrument 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 2, 2018 **(CCE Letter)**.

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GENERAL COMMENTS

The IECA believes that its members are mostly commercial hedgers or commercial hedging end-users and traders of derivatives (both exchange-traded and OTC) primarily for the purposes of hedging commercial risks and asset optimization. These hedging activities foster the development and continued operations of energy infrastructure, the production of energy, the marketing of Canadian natural resources to domestic and international markets and the insulation of customers from price volatility in energy markets. Though the IECA believes that few of its members are likely to be "derivatives dealers" or "derivatives advisers" as defined in the Proposed Registration Instrument, the IECA is offering the following comments in the event the CSA finalizes the Proposed Registration Instrument in its current form into a final national instrument in which those terms are construed too broadly, so as to apply to members of the IECA. The IECA respectfully submits that such a broad construction of the proposals in the Proposed Registration Instrument would have a materially adverse impact on Canadian energy commodity trading and Canadian energy derivatives markets.

The IECA notes that the CSA stated in its notice and request for comment that "the implementation of the Proposed Instrument is therefore subject to the Quebec National Assembly's decision to revoke this exemption" in the Quebec Derivatives Act **(QDA)** for accredited counterparties when they are trading with each other. Therefore, the IECA hereby respectfully asks of the Autorité des marchés financiers **(AMF)** Quebec whether the AMF has started or intends to start the legislative process in the Quebec National Assembly to revoke the registration exemption in the QDA for trades between accredited counterparties.

AFFILIATED ENTITY

Different definitions across different but related rules of the definition of "affiliated entity" would put Canadian companies at a material disadvantage relative to non- Canadian companies, especially U.S. companies who are often the counterparties in the energy space to Canadian energy companies and lend a lot of liquidity to the Canadian derivatives market. One of the key tenets of effective regulation of a market by regulators, the IECA recommends, would be harmonization of a definition such as "affiliated entity" in every national instrument, so market participants do not face an undue burden and hardship that would require an internal corporate restructuring of their organizations to be compliant and to enjoy certain exemptions that the Canadian rules offer affiliated entities.

From a review of the CSA published national and multilateral instruments so far under the mandate to reform the Canadian OTC derivatives market, there is only in one instance connecting affiliated entities by consolidated financial statements in the *National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives* under the Intragroup exemption. Sub-section 7(1) of NI 94-101 provides that "*a local counterparty is exempt from the application of section 3, with respect to a mandatory clearable derivative, if all of the following apply: (a) the mandatory clearable derivative is between a counterparty and an affiliated entity of the counterparty* ***if each of the counterparty and the affiliated entity are consolidated as part of the same audited consolidated financial statements*** *prepared in accordance with "accounting*

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principles" as defined in National Instrument 52- 107 Acceptable Accounting Principles and Auditing Standards". It is IECA's recollection, based on discussions surrounding the proposal of NI 94-101, that the rationale had little, if anything, to do with defining affiliated entities. Rather, it was a result of a discussion of what the availability of the intragroup exemption in NI 94-101 should be. From the proposed NI 94-101 to the final version that is in effect today, the CSA decided to remove this restriction of making consolidated financial statements necessary for prudentially supervised entities as well.

Therefore, the IECA respectfully submits that the control-based definition in the Proposed Registration Instrument, which the CSA has used in all other related rules and national instruments, should be the definition of an affiliated entity. The IECA recommends against adopting the proposed definition in Annex II and believes that using different definitions across different rules would materially disadvantage and cause confusion and additional regulatory burden on Canadian companies.

ELIGIBLE DERIVATIVES PARTY

The IECA supports the comments made in the CCE Letter on the broadening of the definition of eligible derivatives party **(EDP)** so it is consistent with existing derivatives regulations and has no additional comment. Regarding the specific question asked by the CSA whether the criteria paragraphs (m), (n) and (o) in the definition of EDP, the IECA submits that the comments in the CCE Letter address this question and it has no additional comment.

COMMERCIAL HEDGER

The Proposed Registration Rule defines a commercial hedger to mean:

> a person or company that carries on a business and that transacts a derivative that is intended to hedge risks relating to that business if those risks arise from potential changes in value of one or more of the following:
>
> (a) an asset that the person or company owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;
> (b) a liability that the person or company incurs or anticipates incurring;
> (c) a service which the person or company provides, purchases, or anticipates providing or purchasing.

The IECA appreciates the CSA clearly enumerating the items in the definition which provides some clarity on whether a derivative qualifies as a hedging transaction. However, it is unclear from the definition whether a derivative that mitigates a change in foreign exchange rates would qualify as a hedging transaction. The Proposed Registration CP explains that the "concept of 'commercial hedger' is meant to apply to a business entering into a transaction for the purpose of managing risks inherent in its business." The IECA believes that the CSA intends fluctuating foreign exchange rates to be an inherent risk in a business that is involved in international commercial transactions, such as the Canadian energy industry, where a company's working currency, the currency of index prices referenced in its transactions and currency of settlement may not be the same currency. For absolute clarity on this very common scenario, the IECA seeks a clear statement that derivatives that hedge this currency risk which clearly is not intended for speculative purposes

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would be a commercial hedging transaction. Furthermore, as a general statement, the IECA seeks more specific guidance on what transactions constitute a qualifying hedge, similar to what was provided by the Commodity Futures Trading Commission **(CFTC)** in the United States and the European Market Infrastructure Regulation **(EMIR)** by the European Union

Furthermore, the IECA specifically notes its supports of the CCE Letter regarding the importance of reducing the currently proposed $10 million net asset commercial hedger threshold. The membership of the IECA, we believe, are mostly commercial hedgers or commercial hedging end-users and traders of derivatives (both exchange-traded and OTC) primarily for the purposes of hedging commercial risks and asset optimization. Moving from the current regime under the provincial blanket orders having no asset threshold to one that sets a high threshold calculated on the inappropriate measure of shareholder equity will result in smaller companies being denied a tool to manage their risks, which ironically could lead to instability in the Canadian energy industry.

DERIVATIVES ADVISER

The definition of "derivatives adviser" is identical in both the Proposed Business Conduct Rule and the Proposed Registration Rule:

> "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 in respect of derivatives, and
> (b) any other person or company required to be registered as a derivatives adviser under securities legislation;

The wording and guidance with respect to "advisers" is similar to National Instrument 31-103.

The Proposed Business Conduct CP and the Proposed Registration CP state that when making the determination of whether or not an entity is a "derivatives adviser", it should consider its activities holistically and without any particular weight to any one factor. Given the broad nature of the factors, many Canadian energy companies will find themselves captured by the derivatives adviser definition.

Accordingly a clear exemption from the requirement to register as a derivatives adviser is extremely important to energy market participants. The consequences of being deemed a derivatives adviser are significant and energy market participants therefore require certainty that their activities do not inadvertently move them out of the "end user" category into the "derivatives adviser" category. Any additional guidance the CSA could provide on the weighting of specific business triggers for energy market participants, and providing for a long transitional period in the Canadian rules from being an exempted end user to a derivatives adviser, would be essential. Many energy market participants do not have an abundance of resources (both information technology and people) at their disposal, as compared to their derivative dealer counterparts, which may strain their ability to handle know-your-client requirements, counterparty conflict of interest management, or disclosure obligations. In addition, energy market participants may not have the appropriate compliance management staff or individual representatives that have completed the extensive individual training requirements. Therefore,

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if a former end user energy market participant were to transition to the "derivatives adviser" category, it would take a significant amount of time and cost to get the proper processes, software and resources in place.

The proposed rules provide for some exemptions including providing non-tailored general advice, advising affiliates and providing relief for foreign advisers that are registered or authorized under their foreign derivatives legislation. Given the variety of transactions and business structures utilized by energy market participants (including asset management agreements that may include the use of derivatives and the complexity of hedging the risks of joint ventures), it will be difficult to know how the various securities commissions will "holistically" assess their many different activities and transactions. Any advice given by one energy participant to another with respect to a transaction would most likely need to be tailored and may be regularly facilitated based on the relationship between the parties. Further, an entity may want to assist a joint venture entity within its corporate structure with hedging but most likely that joint venture entity will not fall under the definition of "affiliate".

For the above reasons and given that energy market participants transact with other sophisticated energy market participants that are capable of assessing their own use of derivatives, it would be helpful to the energy industry to have an exception similar to the accredited counterparty exemption in Quebec. The statutory exemption under Section 7 of the Quebec Derivatives Act, Chapter I-14.01, for advisers who assist accredited counterparties would be preferred by energy market participants. The Derivatives Act exempts the offering of OTC derivatives from the qualification and authorization requirements (and also from the derivatives dealer registration requirement) where the activities are conducted exclusively with accredited counterparties by an accredited counterparty.

Any foreign derivative advisers (or advisers out of Quebec), including US energy companies will have a competitive advantage over Alberta and other Canadian energy companies that engage in similar activities if the requirements of the other jurisdictions are less stringent. The U.S. swap regulations exempt from CFTC regulatory oversight, within certain parameters, a category of advisors – "commodity trading advisors" – who provide tailored advice to their energy clients but do not have the authority to trade on their client's behalf. Canadian energy market participants would benefit from a similar exemption for providing "guiding" advice without the authority to transact. Again, in the energy industry the participants are sophisticated and do not require all the protections found under the various provincial securities regulations when advising with respect to derivatives with their energy counterparts. Without clear exemptions, many Canadian energy companies may be deemed to be "derivatives advisers" and will incur a substantial compliance burden for essentially the same type of trading activity and services that are conducted across the border in the U.S. or be forced to restructure their business to remain exempt in Canada.

BUSINESS TRIGGERS

The definition of "derivatives dealer" in the Proposed Registration Rule and the Proposed Conduct Rule is anchored to the activity of "engaging in the business of trading in derivatives" and "trading in derivatives for a business purpose". Clarity in the scope of what constitutes these activities is

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of fundamental importance since only parties that engage in those activities will be deemed to be derivatives dealers and therefore subject to the registration and business conduct requirements set forth in the Proposed Instruments.

Inconsistencies in exemptions concerning business purpose factors – "quoting prices". Section 37 of the Proposed Business Conduct Instrument and Sections 48 & 49 of the Proposed Registration Instrument provide exemptions from each Proposed Instrument for certain derivatives end-users, i.e. entities that are not in the business of trading in derivatives. The heading to Section 48 of the Proposed Registration Instrument suggests that Section 48 is intended to only apply to derivatives end-users in British Columbia, Manitoba and New Brunswick. Although not stated in the heading to Section 49 of the Proposed Registration Instrument, it appears that Section 49 is intended to apply in the rest of Canada except for British Columbia, Manitoba and New Brunswick. Also, it appears that Section 37 of the Proposed Business Conduct Instrument is intended to apply in all of Canada without exception. The IECA asks that the CSA please confirm if these inferences are correct?

Each Section noted above describes conduct that would qualify a party for exemptions to the registration and business conduct requirements of the Proposed Instruments. The exemption described in Section 48(c) of the Proposed Registration Instrument differs slightly from the exemptions described in Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument. Section 48(c) of the Proposed Registration Instrument reads as follows:

> (c) the person or company does not regularly quote prices at which they would be willing to transact a derivative or otherwise make or offer to make a market in a derivative;" [emphasis added]

Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument both read as follows:

> (c) the person or company does not regularly make or offer to make a market in a derivative with a derivatives party;

The concept of "quoting prices" has been removed from Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument though it remains in Section 48(c) of the Proposed Registration Instrument. Whether or not this difference was intentional, the IECA respectfully suggests that the language in these Sections should be made consistent by removing the "quoting prices" concept from Section 48(c) of the Proposed Registration Instrument. The IECA believes that a consistent description of this end-user exemption across the Proposed Instruments will facilitate consistent interpretation and application of the Proposed Instruments across Canada.

Less ambiguous and more objective guidance generally. In IECA's September 1, 2017 letter to the April 4, 2017 version of the Proposed Business Conduct Instrument, the IECA, at page 11, urged the CSA to provide a clear, unambiguous definition of derivatives dealer. We expressed concern that the guidance on the business purpose factors was so ambiguous that it allowed for reasonable, but potentially conflicting, interpretations between a market participant and the CSA

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on whether an entity was a derivatives dealer, given the "holistic analysis" approach advocated by the CSA.

The IECA appreciates the clarifications made in the current version of the Proposed Business Conduct Instrument concerning the "quoting prices" concept; however, we believe that further clarifications should be made to the business purpose factors guidance, in both Proposed Instruments, to make that guidance more objective and less ambiguous.

Other factors that the CSA may consider. In both Proposed CPs the CSA states that, with respect to the business purpose factors, it considers the listed factors important, but that the list is not complete and that "other factors may also be considered". The IECA asks that the CSA please explain, or provide examples of, what "other factors" the CSA may consider.

Holistic analysis and weighting of factors. In both Proposed CPs the CSA states:

> In determining whether or not it is, for the purposes of this Instrument, a derivatives dealer, a person or company should consider its 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.

With respect to the quoted statement, the IECA requests that the CSA provide guidance concerning how it might rank the factors in terms of importance as part of a holistic analysis? Also, if meeting any one factor may not be determinative, what threshold of factors being met would be considered determinative?

Proprietary trading vs. dealing. Within the guidance in both Proposed CPs concerning several of the business purpose factors, the CSA appears to draw a distinction between acting as a derivatives dealer and engaging in derivatives transactions for a party's own risk management needs or to speculate in the market (i.e. "proprietary trading"). This distinction appears in the CSA's commentary addressing the "Acting as a market maker", "Transacting with the intention of being compensated", and "Directly or indirectly soliciting in relation to transactions" factors. In addition, the CSA makes the following statement (in the context of a person or company engaging in the discussed factors in an organized and repetitive manner):

> 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 derivative dealer for the purposes of the Instrument.

The IECA supports drawing a distinction between proprietary trading and activities that would deem a party to be a derivatives dealer. The IECA notes that a similar distinction between proprietary trading and swap dealing is made by the CFTC under its swap dealer definition. A clear distinction between derivatives dealing activity and proprietary trading activity should be made in Canada and we urge the CSA to further develop and define this distinction. For example, the CSA should provide a definition of "proprietary trading" within the Proposed Instruments themselves, rather than simply allude to this concept in the Proposed CPs.

With a clear definition of proprietary trading embedded in the Proposed Instruments, the next step would be to include proprietary trading as an express exemption within the current end-user

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exemptions in the Proposed Instruments. In other words, if a party engages only in proprietary trading, which is distinct from the trading derivatives for a business purpose factors, such party would not be deemed to be a derivatives dealer.

In the IECA's view, the CSA has already identified, in the Proposed CPs, activities that would comprise the basis for a definition of proprietary trading, for example, organized and repetitive trading by a party: (i) for purposes of accommodating its own risk management needs, including to hedge specific risks (i.e. a party acting as a "commercial hedger", which is already defined in the Proposed Instruments); and (ii) to speculate in changes in the market value of a derivative, including with the goal of realizing a profit from such changes. The IECA respectfully urges the CSA to turn the commentary about these activities into a clear, concise and substantive definition of proprietary trading within the Proposed Instruments.

Directly or indirectly carrying on the activity with repetition, regularity or continuity. The CSA states in both Proposed CPs that:

> 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 its sole or even primary endeavor for it 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.

The IECA respectfully submits that this business purpose factor should either be deleted entirely from the guidance because the language above is so ambiguous and subjective as to be essentially incomprehensible or be modified to make clear that the activity is "market making activity". Otherwise, how should a party interpret "frequent or regular transactions", or "regularly trading or advising"? By what measures would the CSA determine frequency or regularity?

In addition, we believe that this particular guidance and factor is superfluous to, and potentially conflicts with, other guidance the CSA has provided with respect to the business purpose factors. The "frequent and regular transactions" concept is already adequately addressed within the guidance concerning being a "market maker" and "routinely standing ready" to transact a derivative in response to requests for quotes. It is conflicting because the "frequent and regular transactions" concept is directly at odds with the proprietary trading guidance, discussed above, which correctly recognized that parties could be trading in an organized and repetitive manner, for purposes of making profits, and yet not be deemed to be a derivatives dealer.

Consistency across all Canadian rules. There are a multitude of regulations, and more expected in the future, affecting derivative market participants who are derivatives dealers. The IECA requests that the CSA scopes the business triggers for the definition of derivatives dealer the same across all Canadian rules, current and future. Otherwise, compliance with the variously scoped rules will create administrative burdens and the inconsistency could make market participants vulnerable to inadvertent non-compliance. Respectfully, the IECA cannot see any basis for varying business triggers across the Canadian rules and views any inconsistency as raising needless complexity and risk.

CALCULATION OF NOTIONAL AMOUNT

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In response to the CSA's request to provide comment on the methodologies for determining notional amount, the IECA provides the following comments:

Commodity Options and similar products: Whether column 1 or column 2 is ultimately adopted by the CSA, the notional amount should be calculated using the delta-adjusted forward price, not the spot price. Use of the spot price is not appropriate when valuing deals with a maturity date that is not spot. In the CDE Guidance, Section 2.71 Delta was added into the final technical guidance in response to industry comments stating that the notional amount for options should be adjusted by the delta to reflect the probability of options being exercised. The delta adjusted notional amount reflects the volume of the option that is hedged by a party with a swap and is a more accurate representation of a party's position. ESMA has adopted delta for calculation of the notional amount for purposes of position limits under MIFID II. For example, a gas producer interested in locking in the price of future production may hedge price exposure by selling a swap at a fixed price of $3.00/MMBtu for a volume of 75,000 MMBtu. Alternatively, the producer may sell an option to hedge a comparable level of exposure by selling a call with a strike of $3.50/MMBtu for a volume of 300,000 MMBtu. The delta of the option is .25, resulting in an option delta position (300,000*.25=75,000) equal to the swap volume.

Commodity Forwards and similar products: Physically settled commodity forwards should be excluded from the de minimis notional amount calculation as such products are excluded under the product determinations.

Commodity fixed/float swaps and similar products: Neither methodology is an appropriate measure and, instead, the calculation of the notional amount of a commodity fixed/float swap and similar products should be identical to that for commodity basis swaps, namely, using the spread between the fixed price and the floating price. A calculation based on the fixed price leg of the fixed/float swap does not, it is respectfully submitted, lead to an appropriately calibrated systemic-risked based notional amount.

Commodity Basis Swaps and similar products: Whether column 1 or column 2 is ultimately adopted by the CSA, the price for basis swaps such as locational basis swaps and index swaps such as a gas index spreads should be the spread between the two floating prices specified in the contract, which is viewed as the price of the swap by market participants and is how these swaps are quoted and transacted in the energy commodity markets. Section 2.50 Price of the CDE Guidance recognizes that "[c]ommodity basis swaps and the floating leg of commodity fixed/float swaps, as it is understood in the information included in the data element spread may be interpreted as the price of the transaction".

Under a basis swap, a party's exposure under a basis swap is the spread – the difference in the movement of two prices with respect to one another and not outright price movements on one of the legs. Spread is approved for use by the CFTC in locational basis trades for purposes of the swap dealer de minimis calculation in its FAQ about Swap Entities from October 2012. For entities that engage in de minimis levels of swap dealing in both the U.S. and Canada, a consistent calculation under both regulatory regimes would provide certainty to such entities and reduce compliance burdens of performing two different calculations for the same types of activity.

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Under a gas index spread, one party exchanges the variability of one index for another. For example, in the natural gas markets, one counterparty might pay First of the Month Index price and receive Gas Daily price in exchange. Often, the notional amount of an index spread swap is small given the similarity in the market price of both indices in the forward months. The "fair market value", or "price", is the spread or difference between the two indices.

Commodity swaptions and similar products: Whether column 1 or column 2 is ultimately adopted by the CSA, the use of the delta-adjusted spot price should be used to calculate the notional amount for the reasons stated above under "Commodity options and similar products". It is incorrect to presume that an option is always exercised. If the swaption is exercised into a swap, the notional amount should then be adjusted to reflect the notional amount of the underlying swap transaction (e.g., fixed price*quantity for a fixed vs float swap).

Variable Price/Volume: Under either methodology 1 or 2, for transactions that have varying prices and/or varying volumes, the IECA suggests a weighted average calculation of the price or volume for purposes of the notional amount. The same approach should be taken for a derivative with a notional amount schedule. In addition, the determination of the total notional quantity (under methodology 1) or the monthly approximation (under methodology 2) should be based on the notional quantity that remains to be settled under the swap and not the notional quantity of the entire swap.

Preference for Regulatory Notional Amount Methodology: The Regulatory Notional Methodology, rather than the CDE Guidance Methodology, is a more appropriate approach because it excludes the duration of a swap from the calculation and uses a monthly approximation even with a threshold below $1 billion. The registration trigger is based on an entity being in the business of trading derivatives. If Dealer 1 trades one 30 year swap with 360 monthly calculation periods, Dealer 1 should not have the same notional amount for purposes of dealer registration as Dealer 2 that trades 360 separate monthly swaps. Dealer 2 has 360 times as much dealing activity as Dealer 1. Under the CDE Guidance Methodology, however, Dealer 1 and 2 would have the same notional amount calculation, which is an extremely unfair result for dealers that tend to trade longer dated deals. The right result is found if the Regulatory Notional Methodology is used where only a 1 month volume for Dealer 1's swap is used. If the duration of the derivative is less than 1 month, the total notional quantity would be the appropriate measure of the volume.

Multi-Leg Derivatives: In respect of call spread options, where there are 2 legs to a derivative and the legs are of "like" derivatives with the same volume such as a Buy of a Call Option at $3.25 and a Sell of a Call Option at $3.50 with a notional quantity of 10,000 MMBTU's, the notional amount calculation should be based on 10,000 MMBTU's and not 20,000. In respect of a three-way option collar, the notional amount of one of the "like" options should be added to the "non-like" option notional amount. For example, if a party is the buyer of call, buyer of put and seller of a put, the call option plus one of the put options volume should be added together as only two of the three options would ever be able to be exercised. In respect of a multi-leg derivative consisting of an option and a swap, the notional amount for each derivative type should be determined and then added together.

DE MINIMUS THRESHOLD

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The IECA seeks clarity with respect to the consideration of affiliates in the calculation of the de minimis threshold, specifically Section 51(3)(c) of the Proposed Registration Rule. Within an affiliated group of entities, only those entities that engage in dealing activities should be considered derivatives dealers for the purpose of calculation of the de minimis threshold. While a single affiliate group may have multiple derivatives dealers comprising the group, it should be recognized that an affiliate in that group may not be a derivatives dealer and, as such, that non-derivatives dealer affiliate should not be precluded from benefitting from the exemption just because a member of its group is a derivatives dealer.

Concerning the amount of the commodity de minimis exemption, market price is a component of the notional amount calculation for commodity swaps. As commodity prices rise, so too then will the notional amount calculation. Given the fluctuating nature of commodity prices, there should be a mechanism in the rule to allow the regulators to adjust the de minimis threshold based on a significant change in commodity prices for the major commodities such as gas, power and oil.

The IECA believes that derivatives that hedge or mitigate commercial risk, whether physical or financial, should be excluded from the notional amount calculations. Firstly, the rationale for derivatives dealer oversight does not apply to transactions used to hedge or mitigate commercial risk. The purpose of hedging or mitigating commercial risk is fundamentally different from the purpose of being in the business of trading derivatives or advising others on derivatives, holding itself out as being in the business or trading or advising, or engaging otherwise as specified in Section 6 of the Proposed Registration Rule. Secondly, excluding derivatives that hedge or mitigate commercial risk would align the Canadian rules with the approach taken by the CFTC and by EMIR. The IECA desires that the Canadian rules make it absolutely clear that the derivatives to be included in the calculation of the aggregate month-end gross notional amount are only those derivatives that a derivatives dealer enters into in connection with its business of trading derivatives.

PORTFOLIO RECONCILIATION REQUIREMENTS

Section 44(1) of the Proposed Registration Rule requires a registered derivatives firm to conduct a portfolio reconciliation at least once a year. This raises some questions of practical application. What if a counterparty refuses to engage in the reconciliation exercise? Is the derivatives firm then prohibited from transacting with that counterparty? The CFTC and EMIR have handled these issues by allowing swap dealers to have written policies and procedures in place that are reasonably designed to perform such reconciliation but if a counterparty does not want to engage in the portfolio reconciliation, the swap dealer is not in violation of the portfolio reconciliation requirements. The IECA seeks the CSA to provide similar relief to entities under the Canadian rules.

DISPUTE RESOLUTION

Section 42(1) of the Proposed Registration Rule requires a registered derivatives firm to enter into a written agreement with each derivatives party that establishes when a material terms or valuations discrepancy is considered a dispute and a process for resolving the dispute as soon as

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possible. Under Section 42(3), the registered derivatives firm must report an unresolved dispute to its board of directors and if the dispute is not resolved within 30 days of reporting to the board, the registered derivatives firm must notify the regulators. The IECA proposes that such a reporting requirement should be required only where one of the parties is a "Canadian counterparty".

Furthermore, the IECA proposes that registered derivatives firm should be able to report to the board of directors or an appropriate management committee authorized by the board or appropriate management committee and to the regulators only if the size of the dispute exceeds a material threshold, such as $10,000,000, similar to the requirements imposed by the CFTC in its external business conduct rules for disputes.

PROFICIENCY REQUIREMENTS FOR COMPLIANCE POSITIONS

The IECA understands the rationale and motivation for proposing proficiency requirements for Derivatives Chief Compliance Officers **(CCOs)** and Derivatives Chief Risk Officers **(CROs)**. However, considering that these proficiency requirements have not fully been established in Canada because of the newness in regulating the OTC derivatives market in Canada, it might be very difficult to have many candidates for these important roles to fit the proficiency requirements as provided in the Proposed Registration Instrument. Consequently, the IECA supports the suggestion in the CCE Letter that the CSA create an alternative path of qualification for the CCOs and the CROs if they do not meet all the requirements in the Proposed Registration Instruments.

REGISTRATION TIMING AND DEREGISTRATION

The IECA proposes that the CSA clearly specify the deadline by which entities must register once the registration threshold is met. Under its swap dealer rules, the CFTC has imposed a registration deadline of two months after the day an entity can no longer take advantage of the de minimis exception. The IECA believes that a two-month period is reasonable. The IECA further proposes a tolerance that provides relief from registration in limited circumstances in recognition of the dynamic reality of commercial business. Specifically, an entity should be relieved from having to register in the case it exceeds the registration threshold by no more than 20% in one quarter if, in and during the entirety of the next quarter, the entity remained under the threshold, similar to the CFTC Major Swap Participant rule in the United States. The IECA believes that the risk of non-registration in such circumstance is far overwhelmed by the administrative burden incurred by entities having to scramble to register while registration also becoming unnecessary in the next quarter. Registration in that context, therefore, serves no substantive regulatory function or purpose. Furthermore, once a derivatives dealer is registered pursuant to the rules, the IECA proposes that such entity should be able to withdraw its registration anytime during the one year window after the day an entity should be able to take advantage of registration exemption, provided that during the entirety of that window period and on the date of effective withdrawal the entity was, in fact, exempted from registration pursuant to the Canadian rules.

EXEMPTION UNDER PROPOSED REGISTRATION RULE FOR FOREIGN DERIVATIVES DEALERS

Section 54 of the Proposed Registration Rule provides exemptions for foreign derivatives dealers. The IECA appreciates recognition by the CSA of foreign rules similar to the Canadian rules that

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achieve the same regulatory purpose and result but believes that substituted compliance could be extended further without increasing risk. Specifically, the registration requirement should not be required of US entities that are not required to be registered as a swap dealer under the CFTC de minimis threshold rule.

EXEMPTION UNDER PROPOSED BUSINESS CONDUCT RULE

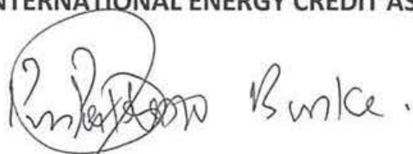
The Proposed Business Conduct Rule applies to all derivative dealers, subject to certain enumerated exemptions. Those exemptions do not include derivative dealers who are not required to be registered under the Proposed Registration Rule; however, the IECA submits that such registration-exempt derivative dealers should be exempted from the business conduct rules for reasons of efficiency, flexibility and simplicity of regulatory oversight, which would harmonize the Canadian rules with the U.S. in this regard. The same considerations made by the CSA in granting the various exemptions from the registration rule including the notional amount threshold for registration should also apply in assessing whether there are real incremental benefits to be gained, and of a magnitude that exceeds the regulatory burdens, in requiring registration-exempt derivative dealers to comply with the business conduct rules. Striking that balance of appropriate regulatory oversight, that is, having sufficient protective measures while managing flexibility to encourage commercial participation, with respect to registration requirements but not to business conduct requirements would produce an inefficient regulatory framework overall.

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



Priscilla Bunke

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WU BUSINESS SOLUTIONS

September 17, 2018

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
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8

Dear Sirs / Mesdames:

Re: CSA Notices and Requests for Comment ("CSA Notices") on Proposed National Instrument 93-101 Derivatives: Business Conduct (the "Business Conduct Rule" or "93-101") and Proposed National Instrument 93-102 Derivatives: Registration (the "Registration Rule" or "93-102") and the related Companion Policies ("93-101CP" and "93-102CP")

Custom House ULC operating as Western Union Business Solutions ("**Western Union**") appreciates the opportunity to comment on the Business Conduct Rule, the Registration Rule and the related Companion Policies. Capitalized terms used in this letter and not defined herein will have the same meaning as in the CSA Notices.

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General Comments

1. Uniform approach across Canada

Western Union is supportive of the CSA's attempts to ensure that a uniform approach to derivatives market conduct regulation is achieved 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 welcomed and we believe it will assist in ensuring an even, competitive playing field for all market participants, inclusive of the FX asset class.

However, the risks of over-regulation are significant and could create undue costs and risks for both derivatives firms and corporate end-users of hedging products. We highlight below a number of proposed provisions in the rules considered unduly burdensome which we feel have little or no practical benefit to counterparties, thereby increasing the threshold costs involved in servicing customer needs, ultimately resulting in a decrease in liquidity and an obstacle to efficient pricing.

2. Broadening the category of hedger eligible derivatives party

We previously requested that the CSA consider broadening the definition of "eligible derivatives party" ("EDPs") to include a hedging exemption similar to the "hedger" category under the "accredited counterparty" definition in the Quebec Derivatives Act and the hedger exemption included as a class of "qualified party" in the various provincial OTC derivatives blanket orders that are currently in force. As highlighted in past CSA Notices, derivatives are different than securities and the risks associated with such products are also different.

In our experience, when commercial enterprises enter into FX derivatives to hedge FX risk, they do so based on detailed knowledge of their business needs and expectations, and related currency exposures. As such, corporate practitioners are using FX hedging products as a risk management tool and not for speculative purposes. This type of hedging activity is a large component of all OTC FX derivatives trading, and complements corporate users' spot market activity for commercial payments and risk management. As these hedges are related to underlying foreign currency assets and liabilities, they do not introduce systemic risk and other regulatory concerns associated with speculative derivatives trading. Given the volume of FX hedging conducted in Canada's economy, the demonstrated sophistication of FX hedgers and the need to have FX derivatives serve as a practical adjunct to spot market trading, this specific sophisticated use of FX derivatives in a commercial context is best served by permitting commercial hedgers the widest range of potential hedging counterparties by eliminating unnecessary regulatory barriers.

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To the extent the CSA considers that additional customer protections need to be layered on when dealing with smaller hedgers, we suggest that the asset threshold required for a hedger to qualify as an EDP should roughly align with the analogous US "eligible contract participant" (ECP) hedger category established under the Commodities Exchange Act. Under the US provisions, a corporation or other entity that has a net worth in excess of US$1,000,000 is permitted to enter into swaps, including foreign exchange options, for the purpose of hedging commercial risk.[1] We believe that setting a threshold more in alignment with the US ECP test for commercial hedgers would be most appropriate. Alternatively, we believe *total* assets of C$10 million would be a more reasonable threshold for commercial hedgers than the current proposal of C$10 million of *net* assets.

3. Implementation Timeline

We appreciate the inclusion of a one year implementation period in Section 45(1) of the Business Conduct Rule. Upon further review of the regulatory, operational, logistics and training requirements required to properly implement the Business Conduct Rule in an orderly manner, we consider that the minimum implementation period should be 24 months. A lengthy implementation period is needed to ensure compliance with the new rules, including time for amending existing policies and procedures, implementing operational measures to ensure requirements are reflected in the trading process (including potential IT operational build-out), training staff on new policies and procedures, amending existing documentation, collecting any new executed customer documentation and developing new reporting requirements.

A full 24 month implementation period is also requested in respect of the Registration Rule given the staffing, hiring and training decisions that will need to be made once a business model is finalized, given the operational and systems measures which will need to be taken to implement the requirements and put appropriate controls in place, and given the need to produce policies and procedures and complete the registration process.

[1] See 7 U.S. Code Sect 1a(18)(A)(v)(iii). The US ECP test applies only to options, as the U.S. Treasury has excluded FX forwards from application of the provision and entities may enter into FX forwards without meeting any asset qualification. See, https://www.treasury.gov/press-center/press-releases/Pages/tg1773.aspx.

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Business Conduct Rule Comments

4. Description of the Scope of the Business Conduct Rule Fair Dealing Requirement in the Companion Policy – Suitability and "Fair Pricing" Obligations

We recognize the policy rationale for including a fair dealing obligation in the Business Conduct Rule that is aligned with the obligation imposed on registered securities dealers "to deal fairly, honestly and in good faith with its clients".

However, it is important not to expand this obligation to include suitability obligations that are properly addressed under Business Conduct Rule section 11. Moreover, it is not appropriate to add general fair pricing obligations which are inconsistent with securities laws, market practice and customs, free market policies and the nature of typical negotiated derivatives transactions between a buyer and seller where both parties are dealing at arm's-length having confirmed their ability to represent their own best interests.

Fair Dealing and Suitability: In respect of suitability, the fair dealing section of the Business Conduct Rule Companion Policy (93-101CP s. 8) states that:

> "…deliberately selling a derivative that is not suitable for a derivatives party, would not be considered to be "fair" and, in our view, would be a breach of the fair dealing obligation."

We believe that consideration of suitability is more properly addressed under Section 12 (Suitability). Our understanding is that dealers should not be expected to conduct suitability analysis in respect of EDP counterparties, but this Companion Policy statement could improperly require dealers to consider suitability when dealing with EDPs which would be a new, inappropriate and burdensome obligation.

Fair Dealing and Pricing Obligations: The draft Business Conduct Rule Companion Policy (93-101CP s. 8) suggest that dealers would be constrained in determining the pricing that may be quoted to particular counterparties, and that a specific fair and "rational" basis for pricing each transaction must be established. These statements include the following:

> "As part of the policies and procedures required under section 30, a derivatives firm is expected to be able to demonstrate that it has established and follows policies and procedures that are reasonably designed to achieve fair terms, in the context, for the derivatives firm's derivatives parties…"

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> "We interpret the fair dealing obligation to include determining prices for derivatives transacted with derivatives parties in a fair and equitable manner."

Our view is that there should be no fair dealing pricing obligation for dealers negotiating pricing terms with a counterparty in an open and competitive market on an arm's-length basis, nor should there be an obligation to establish policies and procedures designed to achieve fair terms. Mandatory legal obligations describing pricing levels that should be offered are not consistent with open market practices where competition is readily available and de facto fair pricing between parties to bilateral negotiations exists as a foundational element of open market trading. We do however support a requirement that dealers adopt policies designed to prevent predatory or manipulative pricing behaviours and high-pressure sales tactics.

We note that no such requirement is reflected in the CFTC's Business Conduct Standards applicable for swap dealers. The CFTC Standards recognize that fair dealing is achieved through disclosure to counterparties of material information concerning the transaction, a fair and balanced communications requirement, and the prohibition of fraud, manipulation and other abusive practices.

Dealers are compelled by competitive pressures to provide pricing on a competitive basis in the context of the market, but dealers compete on a very broad range of factors that define their service offerings including for example the platform and execution venue, the certainty and finality of execution, the time that offers are left open, the number of quotations that are provided by voice or through a price streaming service, the extent to which credit or leverage is provided, the reporting and post-transaction support that is provided, and the integration of derivatives transactions with other services provided by the dealer. Any specific pricing obligations for arm's-length voluntary bilateral transactions are inconsistent with free market principles and the current operation of derivatives markets and would reduce liquidity and improperly suggest to customers that they can automatically rely on dealers for determining fair pricing.

We recognize that there are important policy grounds for protecting vulnerable Non-EDPs from improper sales practices including high-pressure sales tactics and "predatory" behaviours such as making misrepresentations and providing misleading scenario analyses. However, this does not mean that some ideal of fair pricing is appropriate, or even possible.

We note that there are no analogous obligations imposed on securities dealers. For example, securities dealers are not obliged to provide spot FX transaction pricing "on fair terms" or to sell securities or issue loans at specific interest rates that are determined in a fair and equitable manner. We believe that if it is not appropriate to impose specific pricing obligations on spot FX transactions that may often

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involve customers with less sophistication and less bargaining power than derivatives parties, then it is not appropriate to impose these pricing obligations on FX derivatives transactions.

FX dealers quote both spot and forward prices to clients competitively based on numerous market considerations and their clients choose services based on a consideration of a broad range of factors. This is of course a large market that functions with minimal regulation and as a result is very efficient and highly competitive. It would be fundamentally anti-competitive if FX spot providers could not quote prices in such an unrestricted manner. In the same way, FX swap providers need this flexibility to supplement FX spot pricing with FX forward pricing which is determined without any fair pricing restriction.

If a dealer has taken the time to satisfy its disclosure obligations in good faith, and the client has the opportunity to consider pricing (including competitor offerings) and consult third parties prior to committing to a transaction, then there should be no sweeping obligation to "determine prices in a fair and equitable manner" or to establish methods for tracking compliance with this nebulous concept. If there are concerns about counterparties not understanding derivatives pricing, then that should addressed through Business Conduct Rule section 19 (Pre-transaction disclosure).

Disclosure of "Implications of Terminating a Transaction": Business Conduct Rule Companion Policy section 8 (fair dealing) includes the statement that: "[The CSA] also expect the derivatives firm to provide a derivatives party with information about the implications of terminating a derivative prior to maturity, including potential exit costs."

We ask for this sentence to be clarified to state that it only applies when a termination is being discussed or negotiated. Our concern here is that this sentence might be interpreted as imposing an additional pre-transaction disclosure obligation that applies in respect of every individual transaction. The implications of terminating a derivative, including costs, are wholly dependent on market conditions existing at the time of termination and it is not practicable to meaningfully disclose such implications prior to entering into the transaction.

5. Obligations to Assess a Client's Needs and Objectives and the Application of the Suitability Requirement to Dealers Contracting at Arm's Length

Western Union anticipates entering into FX forward and option transactions with a broad range of business clients which are fully capable of assessing the merits of hedging FX risks and managing their own FX needs and exposures. We consider that it is imperative that clients be permitted to make their transacting and hedging decisions free from Western Union interference. We do not second-guess clients that enter into spot FX contracts and we believe the same principle should apply in

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respect of FX forwards and options. However, certain provisions included in the proposed Business Conduct Rule in respect of suitability obligations and the need to establish suitability run counter to this basic commercial premise.

We recognize that in order to qualify a client as an EDP under the commercial hedger category, we should confirm that the client has commercial exposures to a particular currency, but we do not consider that this means that the particular hedging decisions being made by a client each time it transacts need to be recorded. In our view, so long as the transaction fits the client's hedging profile (e.g., managing USD exposure in an amount of less than $200 million notional), then there should be no further requirement to confirm hedging criteria in respect of each individual transaction. We expect this makes sense both from a policy perspective and a practical implementation standpoint, and provides adequate protections for clients which have asserted that they should be treated as hedging EDPs.

Dealers generally transact at arm's length with counterparties. It would be helpful for the CSA to confirm in 93-101CP s. 11 that when entering a transaction with a counterparty that is requesting to enter into an FX transaction, there is no need to go further and inquire as to the nature of the counterparty's commercial objectives such as the basis on which the counterparty determined the size, timing and tenor of the transaction. – Such an inquiry is not appropriate to arm's-length negotiations. However, the current Companion Policy discussion seems overly skewed towards considering cases where a dealer or adviser is providing advice or execution services to a client (as opposed to simply acting as an arm's-length counterparty), which improperly suggests that additional actions need to be taken even by an arm's-length dealer. For example, 93-101CP s. 11 provides that:

> "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 the impact of making a trading interest public.
>
> Before transacting with a derivatives party, we expect a derivatives firm to have the appropriate information 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."

Ultimately, a dealer that is quoting prices on an arm's-length basis should not be subject to this scope of KYC burdens including in particular the obligation to

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determine "the derivative's party's objective in entering into the derivative and the risks involved". The dealer should only need to confirm that the counterparty appears to have the competence to understand the terms of the relevant transactions and to use derivatives as part of its business. It is not appropriate to ask a counterparty to disclose additional commercial information as a condition to transacting and we do not consider that in this situation it would be appropriate to advise a counterparty, as suggested in 93-101 s. 12(2) and 93-101CP s. 11, that "the information is required to determine whether the derivative is suitable for the derivatives party, and without this information there is a strong risk that [the dealer] will not be able to determine whether the derivatives party has the ability to understand the derivative and the risks involved with transacting the derivative". If the counterparty and the dealer agree that the dealer will not be responsible for determining suitability, then the dealer should focus on transaction terms and not ask questions which suggest that the dealer is determining suitability.

We would like to emphasize that this is consistent with the international approach to conduct regulations. In particular, we note that CFTC Conduct Rule 23.434 (Recommendations to counterparties -- institutional suitability) only applies where a dealer or adviser recommends a transaction or trading strategy, and a safe harbour is provided that disapplies the provision if a dealer discloses in writing that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of the swap or trading strategy involving.

6. Overlapping KYDP Requirements in Business Conduct Rule section 10

Section 10 of the Business Conduct Rule imposes certain KYDP obligations which appear to be loosely based on anti-money-laundering legislation but not strictly consistent with existing legal requirements and there does not appear to be a strong policy justification for imposing such additional requirements under the Business Conduct Rule. Although the related Business Conduct Rule Companion Policy refers to dealers having a "gatekeeper role" which requires derivatives firms to establish the identity of, and conduct due diligence on, their counterparties, we consider that this role should not apply from a derivatives policy standpoint to dealers that only transact at arm's-length with their counterparties.

We recognize that diligence is required from a commercial standpoint to address credit exposures, but we do not consider that it is necessary to layer onto this an undefined obligation to consider "the reputation of the derivatives party" (s. 11(2)). – We do not have a view as to whether this is an appropriate obligation to impose on dealers that are transacting on behalf of third parties, but where a dealer transacts opposite a third-party this is not an appropriate obligation to impose.

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Furthermore, like numerous money services businesses and securities dealers, Western Union is subject to and complies with the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA) and we do not consider that it is appropriate for derivatives legislation to alter those requirements or attempt to layer on similar requirements. For that reason we consider that Section 10(3) which is directed to identifying ultimate beneficial ownership of counterparties should not apply to dealers that are already subject to the PCMLTFA.

7. Disclosure Obligations in respect of Referral Arrangements

We do not consider that referral arrangements should be required to be disclosed if the referring party has no ongoing role in the derivatives relationship (Conduct Rule ss. 13(1)(c), 15 and 18(1)(e)). For example, if a dealer acquires a list of business leads in accordance with existing contractual obligations and applicable laws, then the pricing agreed for these referrals should not be subject to disclosure. The CSA may have concluded that this disclosure is necessary in some advisory context where the referring firm continues to have some derivatives-related involvement with the client, but generally this type of disclosure is not and should not be required for derivatives dealers. To the extent any disclosure is required, we would request that the final rule not require a disclosure of the exact quantum of fees, but rather, simply the disclosure of the fact that a fee is paid.

8. Pre-transaction Pricing Disclosure Obligations in respect of Arrangements

The disclosure obligations under Conduct Rule section 19(2) to disclose "if applicable, the price of the derivative to be transacted and the most recent valuation" before transacting in a derivative are unclear to us, perhaps because we do not understand when the price and value of a derivative would be "applicable" (e.g., does this only refer to transactions that are already outstanding and therefore have a "most recent valuation"?).

It is not clear what disclosure would be required if a dealer is proposing to enter into a new transaction. If the dealer offers to enter into the transaction on particular terms at a particular rate, is the offered rate the "price" of the derivative and is there a "most recent valuation"?

To the extent disclosure of market prices or mid-market rates is required, we strongly request that such market information should only be provided upon client request, or that clients may waive the right to receive such disclosure. It is generally possible to provide an end-of-day fair value valuation of outstanding transactions which is useful for certain limited purposes and is determined based on relatively well-understood principles and a pool of market data, but this daily valuation data may not reflect pricing available in the market, is often not

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available intra-day, and it would be difficult in the context of pricing a particular derivative to explain the assumptions that have been made in reaching the valuation, what the time cut-off or pool of data used is for this purpose or how such valuation may not provide all of the relevant information for determining the terms on which the client should be able to enter into a transaction in the broad market or with specific dealers. For these and other reasons, it is difficult and time-consuming to provide such specific valuation information in the context of a particular transaction, and any obligation to provide such information may frustrate the ability to offer stream-lined FX hedging services by voice or electronic means.

To the extent available inter-day benchmark pricing is relevant as the principal factor in determining mid-market pricing, such information usually reflects rounded standard periods (e.g., 1 month forwards, 3 month forwards) which will often not align with the customized negotiated transaction, and we and other dealers would be contractually restricted in sharing this information under a live feed which would be necessary to operationalize this type of valuation disclosure information for various stream-lined transaction models.

We note that no-action relief has been granted under CFTC Letter No. 13-12 which exempts CFTC rules swap dealers from the requirement to provide pre-trade market pricing information for most ordinary FX forwards and swaps. In particular, the exemption applies if the transaction is "(1) a foreign exchange swap or forward that, by its terms, is physically settled, where each currency is one of the BIS 31 Currencies [i.e., the top 31 currencies (by volume) described in a particular BIS report] and where the transaction has a stated maturity of one year or less, or (2) a vanilla foreign exchange option that, by its terms, is physically settled, where each currency is one included among the BIS 31 Currencies, and where the option has a stated maturity of six months or less; (b) real-time tradeable bid and offer prices for the transaction are available electronically, in the marketplace, to the counterparty; and (c) the counterparty to the transaction agrees in advance, in writing, that the [Swap Dealer or Major Swap Participant] need not disclose a [pre-trade mid-market mark]".

Given the operational difficulties, costs and disruptive timing implications associated with making this disclosure available, it is important that the Canadian disclosure obligation does not exceed what is provided under CFTC rules for swap dealers and so we would request that this carve-out from pricing disclosure be provided in respect of at least the enumerated types of FX transactions. Furthermore, given that the overwhelming majority of all FX transactions only involve the BIS 31 currencies referred to in the CFTC letter and real-time tradeable bid and offer prices are generally available in the market, we would suggest that the CFTC exemption could be simplified for use in Canada by not including the limitations set out in clauses (b) and (c) above.

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9. The General Segregation Obligation and the Identification Derivatives Party Assets

For dealers transacting with counterparties on an arm's-length basis, it is not appropriate to require segregation of collateral. For that reason, we consider that the body of the Business Conduct Rule s. 24 (and not just the Companion Policy) should describe "accounting segregation" as sufficient, and a statement should be included in the Companion Policy that accounting segregation is consistent with re-use or rehypothecation of collateral.

We also consider that the definition of "derivatives party assets" should be more precisely defined. The term is currently defined in the Business Conduct Rule as follows:

> "derivatives party assets" means any asset, including collateral, received or held by a derivatives firm from, for or on behalf of a derivatives party;

This definition could be interpreted (or misinterpreted) as including assets that are transferred outright to a dealer by a customer (and not merely pledged) as well as assets delivered to a dealer that are not directly related to derivatives transactions.

Where a dealer is transacting on an arm's-length basis with a counterparty, assets which are transferred outright to the dealer should not be subject to any ongoing obligation. Such assets are equivalent to payments and of course there should be no obligations owing in respect of money or securities which are transferred outright in satisfaction of derivatives obligations.

Furthermore, we consider that only assets that are held primarily as security for derivatives should be characterized as derivatives party assets. A dealer may have a number of relationships with a counterparty which could involve various custody and pledging relationships. Only those assets which are pledged to or required to be maintained with a derivatives dealer as a condition or term of the derivatives relationship should be considered to be derivatives party assets for which particular business conduct obligations apply.

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10. Material Non-Compliance Reporting Obligation
Business Conduct Rule section 32 imposes an obligation on derivatives firms to report to the relevant regulator material non-compliance with the Business Conduct Rule or derivatives laws. This obligation goes significantly beyond the requirements imposed on securities dealers and we do not see any justification for this type of requirement. Derivatives firms' primary obligations will be to comply with derivatives laws, and sufficient internal controls have already been proposed in the Business Conduct Rule which should be satisfactory to achieve the regulatory objective in respect of firms that are conducting operations in good faith with the intention of complying with laws.

This same comment applies in respect of Registration Rule section 27(3)(d) which essentially reproduces the Business Conduct Rule section 32 reporting requirement.

Registration Rule Comments

11. Requirement for IIROC Membership if Dealing with Individuals that are Non-EDPs
We see no justification for requiring a dealer to become an IIROC member in order to transact with an individual that is not an EDP (Registration Rule section 9). This is an extremely anti-competitive step that would likely have a severe impact on hedging options available to individual entrepreneurs.

The Proposed Rule does not set out any justification for this requirement in the Proposed Rule, nor have the market impact, costs and operational burdens that this will introduce been evaluated and described in the Proposed Rule. The IIROC qualification regime and rules are patently not appropriate for regulatory oversight of derivatives firms which in the past has been recognized by CSA members which as a result have not required derivatives firms to register with IIROC. Very significant revisions to IIROC's rule book and the elimination, for example, of the IIROC requirement for members to be Canadian corporations would be required in order to make IIROC an appropriate regulatory body. Even if IIROC were to undertake this project, there are significant risks that the interests of current IIROC members could bias IIROC towards over-regulation and unnecessarily burdensome membership and capital requirements. We do not consider that it is appropriate for the CSA to pass off the responsibility to determine the membership requirements and scope and terms of regulation of OTC derivatives markets to a securities self-regulatory organization, and we are strongly opposed to the additional financial burdens and fees that would inevitably result with no demonstrated regulatory benefit and an undeniably negative impact on market competition and liquidity.

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12. Registration Requirements and Exemptions for Dealing Representatives
We share the view expressed by other comment letters that registration of individual dealing representatives and advising representatives is not appropriate for the derivatives markets. We do not object to identifying a UDP, CCO and CRO, but the specific registrations obligations are not necessary so long as a registered firm confirms proficiency of its representatives under Registration Rule section 18.

To the extent the registration obligation for individuals is retained, we ask that the CSA clarify Registration Rule section 58 to make clear that in order to rely upon the exemption from advisor registration obligations the individual representative only needs the proficiency required under section 18(1). As currently drafted, section 58 could be read as implying that a registered dealing representative would not be able to provide incidental advice in connection with a transaction if the individual does not have a CFA Charter or otherwise satisfy the requirements in section 18(6). We do not consider that such a requirement is reasonable and would in effect largely eliminate the benefit of providing the section 58 exemption. We note that if section 18(6) is intended to apply then we request that section 18(7) (which provides an exemption to representatives of registered advisers from the section 18(6) CFA requirement if the representative only advises EDPs) should be stated to apply for representatives of derivatives dealers to eliminate the section 18(6) CFA (or similar) requirement if the individual is only advising EDPs.

However, we consider that the section 18(6) CFA (or similar) requirement is not necessary or consistent with the international regulatory approach. Individuals working as dealing representatives will very often be fully capable of providing investment advice in respect of derivatives without having completed the CFA Charter (which of course covers a very broad span of securities matters with relatively minimal focus on derivatives) or two courses and 2 years of investment management experience (which experience dealer representatives generally will not have as they are not employed to manage funds or accounts).

As a related point, a *non-registered* dealing representative should also have the benefit of the section 58 exemption from adviser registration obligations if the non-registered dealing representatives is only advising EDPs. This change is required in order to parallel the exemption in section 16(4) which permits individual representatives of registered advisers to deal with EDPs without registration.

13. Portfolio Reconciliation Obligations
We consider that the Registration Rule section 44 portfolio reconciliation requirements for derivatives dealers facing non-EDPs are redundant and unnecessary given that they overlap fully with daily valuation reporting obligations and the obligation to deliver quarterly statements that apply under Business Conduct Rule ss. 20(1) and 28. The quarterly statement delivery

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requirement adequately spells out all of the details that would typically be included in a portfolio reconciliation report. It is unnecessary to require dealers to include in their client relationship agreements a new provision requiring counterparties to review and confirm the quarterly statements as part of portfolio reconciliation. As non-EDP counterparties will already be receiving the relevant reports, it is unnecessary to impose a new obligation requiring the counterparty to review such reports and confirm agreement.

Portfolio reconciliation obligations have been imposed on large financial institutions in cases where there is no obligation for dealers to provide quarterly reports. Furthermore, the OSFI requirement under OSFI Guideline B-7 only applies where there are a material number of derivatives outstanding with a counterparty.

14. Portfolio Compression Obligations

We consider that the Registration Rule section 45 portfolio compression obligations are an unnecessary burden which will provide little if any practical benefit.

In respect of section 45(1)(a), this obligation to terminate fully offsetting derivatives could be problematic because many dealers (e.g., FRFIs) will be exempt from the obligation and so there is no mutual obligation to terminate. Of course, in practice both parties will frequently agree to terminate fully offsetting derivatives but if there is some dispute between the parties as to whether transactions are truly fully offsetting then the inclusion of the obligation would be problematic.

In respect of section 45(1)(c), if the provision is retained we would appreciate if it was limited to only apply "for portfolios with large numbers of uncleared derivatives contracts containing substantially similar economic terms" where the compression could reasonably be expected to materially "reduce the risk, cost, and inefficiency of maintaining redundant transactions on the counterparties' books". These limitations on the compression obligation are set out in the parallel requirement under OSFI Guideline B-7, are an appropriate description of the circumstances when compression is appropriate, and will align non-bank dealers' obligations with those of chartered banks that are their counterparties.

15. Reporting of Disputes to Regulators

We considered that disputes which are unresolved after 30 days of internal escalation (i.e., reporting to the board) should only be reportable to regulators under Registration Rule section 42(4) if the disputes would reasonably be expected in aggregate to have a material adverse impact on the registered firm.

* * *

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.

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Counsel, Western Union Business Solutions

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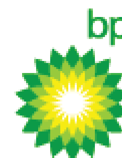

September 17, 2018

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 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

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Corporate Secretary
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Montréal (Québec) H4Z 1G3
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c/o:
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Secretary
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Email: comments@osc.on.gov.ca

Dear Sirs/Madams:

Re: Comments on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy

BP Canada Energy Group ULC and its affiliates ("BP") appreciate the opportunity to provide the Canadian Securities Administrators ("CSA") comments on the following documents:

- Proposed National Instrument 93-102 Derivatives: Registration ("Proposed Registration Rule);
- Proposed Companion Policy 93-102: Derivatives Registration ("Proposed Registration CP").

BP's business in Canada encompasses a range of activities including the exploration, production, purchase and sale of hydrocarbons and other energy commodities. As a major participant in the marketing and trading of Canadian natural gas and crude oil, BP also manages risk and maximizes value across physical and financial markets through its participation in the Canadian over –the-counter ("OTC") energy derivatives market.

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BP has reviewed the Canadian Commercial Energy Working Group's ("CCE") comment letter on the Proposed Instrument submitted by Eversheds Sutherland (US) LLP on August 2, 2018 (the "CCE Letter") and is generally supportive of the CCE comments. BP will not duplicate the comments in the CCE Letter, but would encourage the CSA to consider and incorporate the comments and requests set forth therein in any Final Registration Rule.

BP also respectfully requests that the CSA consider BP's additional comments with respect to the following:

A. The Scope of the General De Minimis Exemption (Section 50) and the Commodity De Minimis Exemption (Section 51)

BP appreciates the CSA providing for the General De Minimis Exemption and the Commodity De Minimis Exemption in the Proposed Registration Rule and generally supports the comments made in the CCE Letter pertaining thereto. BP would also respectfully request that the CSA consider the following additional comments:

(i) *Treatment of Affiliates*. As currently worded, BP interprets sections 50 and 51 of the Proposed Registration Rule as requiring an entity having its head office or principal place of business in a jurisdiction of Canada ("Party A" or a "Canadian domiciled entity") to include in its de minimis calculation, all of its outstanding derivative transactions and all outstanding derivative transactions of all affiliated entities Canadian domiciled and non-domiciled (excluding transactions between affiliates). BP shares the CCE's concerns that such approach is potentially disadvantageous for Canadian derivative market participants who could be prohibited from relying on the de minimis exemptions by virtue of an affiliate's derivatives activities which, in BP's view, are outside the scope of activities the CSA intends to capture. BP would respectfully request that the CSA consider excluding the notional amounts of derivative transactions of those affiliates of Party A that are (a) registered, licensed or otherwise authorized to conduct derivatives activities, or (b) exempt from registration, under the laws of Canada or the laws of a recognized foreign jurisdiction. BP would respectfully submit that for any other non-Canadian domiciled affiliates, only those transactions with Canadian counterparties should be included when calculating the de minimis threshold of Party A.

Commodity de Minimis Exemption: As currently worded in section 51 of the Proposed Registration Rule, the Commodity de Minimis Exemption is only available to a person or company that is only a derivatives dealer in respect of commodity derivatives. BP would like to receive some guidance or clarification as to how the CSA would view foreign exchange ("FX") derivative transactions executed by a commodity derivatives dealer. Many market participants in the commodity derivatives market have a functional currency for accounting purposes but transact in multiple currencies and they will often hedge the resulting exposure through FX derivatives transactions. BP would respectfully submit that a commodity derivatives dealer who enters into FX derivative transactions for hedging purposes should not be viewed as "dealing" in non-commodity derivatives and consequently prohibited from relying on the Commodity de Minimis Exemption. Therefore, BP would respectfully request that the CSA consider providing clarity that FX hedging transactions would not preclude a company from being entitled to rely on the Commodity de Minimis Exemption.

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B. **Eligible Derivatives Party**:

BP supports the comments made in the CCE Letter in respect of expanding the definition of eligible derivatives party ("EDP") in the Proposed Registration Rule so that it is consistent with existing derivatives regulations.

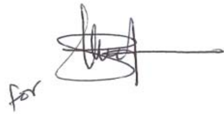
C. **Calculation of Notional Amount**:

BP appreciates the CSA putting forth two proposals in respect of the calculation of notional amount in the Proposed Registration Rule and believes that it is important that any methodology adopted is reflective of how market participants would view the price under a derivatives transaction. For this reason, BP does prefer the Regulatory Notional Methodology with the modification requested in the CCE Letter to use the difference between the two floating prices as the "price" when calculating the notional amount of float-for-float swaps. BP would also however, urge the CSA to use the difference between the fixed price and the floating price as the "price" when calculating the notional amount of fixed-for-float swaps, as it is similarly reflective of how market participants would view the price in a fixed-for-float swap and therefore the more useful valuation for the purposes of the de minimis calculations.

BP respectfully submits its comments set forth in this letter and thanks the CSA for seeking and considering comments from interested stakeholders.

Respectfully submitted,

BP Canada Energy Group ULC



Stephen Connelley,
CFO, IST

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September 17, 2018

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
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Dear Sirs/Mesdames:

Re: **CSA Notice and Second Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (collectively, the "Business Conduct Proposals")**

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to provide the following general comments on the Business Conduct Proposals and reply to the specific questions below.

[1]The CAC represents more than 15,000 Canadian members of 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 of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 154,000 CFA charterholders worldwide in 165+ countries and regions. CFA Institute has eight offices worldwide and there are 151 local member societies. For

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While we will not be responding in a separate comment letter to the request for comments on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (collectively, the "**Registration Proposals**"), we considered the Registration Proposals in the context of our responses below and wish to comment on certain discrete aspects of those proposals.

The CAC supports the bifurcation of the Registration Proposals from the Business Conduct Proposals, in that we agree all derivatives advisers and dealers should be subject to certain minimum conduct standards, even if their activity does not trip the business trigger for registration. While there is room for debate on the scope of the Registration Proposals, particularly as it relates to incidental activity that would not trigger a registration requirement, we support the principles behind the Registration Proposals and the Business Conduct Proposals, which include reducing systemic risk and meeting IOSCO's international goals. We are also supportive of more harmonized standards for listed derivatives and OTC derivatives, particularly with respect to the reporting and disclosure by derivative parties.

The CSA should consider specifying in detail a de minimus exemption from the adviser registration requirement, particularly for portfolio managers utilizing OTC derivatives occasionally or for currency hedging in their managed investment funds/segregated portfolios, in order to have certainty with respect to whether such advisers require registration under the derivatives regime separate from their registration under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"). This more clearly delineated de minimus exemption could be based on a low notional amount of outstanding derivatives and/or a small percentage of the net asset value of the portfolios. Advising in currency hedging only in the context of managed portfolios/investment funds could also explicitly be excluded. This would be preferable to a case by case or registrant-led determination of whether an entity is in the business of advising on derivatives. Some firms might commence the registration process out of an abundance of caution which would not be an efficient use of resources for either these firms or their regulators given the stated goals of the proposals.

The Registration Proposal includes requirements for risk management policies and procedures, including a requirement for an independent review of risk management systems. While we support the importance of independent reviews and raising awareness about risk and market stability, there are a few potential issues with the implementation of this requirement. The obligation may impose additional requirements and costs on smaller firms that may not have the resources for an internal independent review, especially those smaller firms that might otherwise fall outside of the scope of the Proposal should a de minimus threshold for derivatives advice exist, such as the one outlined above. Having to engage an external party to perform an independent review

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will require initial and ongoing due diligence and conflict analysis, and impose additional costs and oversight requirements on these firms. The effectiveness of this requirement will also vary based on the persons or firms providing the independent review, and thus additional guidance on the qualifications and experience of the reviewers, together with expectations on the scope of the review would be helpful. Evaluating the effectiveness of a risk management framework should be based on a meaningful understanding of the firm being evaluated, as well as how the firm's activities intersect with other entities within the larger financial system and contribute uniquely to systemic risk.

We understand that a number of the provisions in the Business Conduct Proposals were modified from existing provisions in NI 31-103 to reflect the nature of the derivatives markets. However, the CAC believes that additional guidance and outreach to current registrants who will be required to register in additional derivatives categories by the Registration Proposals will be quite critical for smooth implementation of the two proposals. For example, while it is clear that the definition of an "eligible derivatives party" will differ from the current definition of a "permitted client", the regulatory expectations for registrants dealing with or advising persons and entities from either or both categories is less clear. Additional guidance, registrant outreach, and easily-utilized tools for registrants would be helpful.

While Appendix A in the consultation paper contrasts the approach of the Business Conduct Proposals to NI 31-103, it is only the context of the applicability of certain provisions, and not in the context of specific new requirements that existing (or new) registrants should implement that go above and beyond existing NI 31-103 compliance mechanisms. An appendix identifying the difference in the two definitions of "permitted client" and "eligible derivatives party" would also be of benefit to registrants subject to the rules.

Registrants who are currently meeting their obligations under NI 31-103 by having a robust culture of compliance, effective policies and procedures and staff who understand the KYC, KYP, and suitability determinations may still struggle with the Business Conduct Proposals without targeted, specific information with respect to the additional policies and procedures expected of them under the new regime for OTC derivatives. The vast majority of registrants wish to comply with regulatory changes and expectations at the outset, but without additional guidance they may fall offside, resulting in significant deficiencies requiring both regulatory and registrant resources to rectify. While every registrant's business and policies differ, efficiencies would be gained if there were, for example, an illustrative list of additional policies or changes to policies and procedures that should be considered in light of the new requirements for common existing categories of registration. Registrants would benefit from additional tools and explanations, through guidance notices, registrant outreach, staff notices or otherwise, to help meet their new obligations.

As another example, Section 12 of the Business Conduct National Instrument describes a derivative firm's suitability obligation prior to transacting in a derivative. In principle, we understand why there needs to be a more robust process for "retail clients"

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as compared to eligible derivative parties. However, it is unclear how the suitability determination should differ from the existing suitability determination obligation under NI 31-103. Many existing registrants already have a vigorous KYC process for individuals, including with respect to their experience with investing in various types of securities. However, the proposed new Companion Policy 93-101 suggests that for derivatives in particular, the requisite KYC information needed would differ on a case by case basis, which may be difficult to apply in the absence of additional information as to what is required in various circumstances. Additional guidance for registrants with respect to a client's experience with investing in derivatives could be beneficial, not only for KYC purposes but in connection with certain branches of the definition of an eligible derivatives party.

We wish to respond to the specific questions posed as follows.

1) *Definition of "affiliated entity". The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.*

The definition should likely be expanded to include discretionary portfolio management/advisory authority, as many investment managers will have advisory relationships with managed accounts and investment funds that they do not control by virtue of the definitions, and also do not consolidate for accounting purposes.

3) Anonymous transactions executed on a derivatives trading facility. We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption? We are also considering whether a similar exemption should be available in other scenarios, including, for example: (a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and (b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency. Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

Exemptions are provided from certain provisions of the Business Conduct Proposals for derivatives traded with an EDP on a derivatives trading facility that are submitted for clearing, where a firm may not know the identity of its derivatives party prior to the anonymous execution of a transaction. We note that the OTC derivatives market continues to rapidly evolve, and trades executed on certain multi-level trading platforms that may not be submitted for clearing should be considered for a similar exemption or exemptive relief on a case by case basis if such platforms become widely

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adopted outside of Canada. It is important that the Business Conduct Proposals do not artificially limit innovative trading platform adoption in Canada.

6) Policies, procedures and controls. Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.

Additional guidance and outreach to current registrants with respect to any such requirement will be critical.

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 cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council for Canadian CFA Institute Societies*

The Canadian Advocacy Council for Canadian CFA Institute Societies

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September 17, 2018

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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:
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c/o:
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Secretary
Ontario Securities Commission
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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

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[1] *See* CSA Notice and Second Request for Comment on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy (June 14, 2018) ("**CSA Notice**"), http://www.albertasecurities.com/Regulatory%20Instruments/5408723v1_93-101%20CSA%20Notice.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. Market Participants Relying on the Proposed Registration De Minimis Exemptions Should Not Be Treated as Derivatives Dealers Under the Proposed Instrument

The Proposed Instrument would impose business conduct obligations on "derivatives dealers." However, the scope of the proposed derivatives dealer definition is overly broad as it would extend beyond those required to register as derivatives dealers. Specifically, Proposed NI 93-101 defines a "derivatives dealer" 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 securities legislation."[2]

The Proposed Companion Policy appears to expand the proposed derivatives dealer definition as it states that the definition also captures entities "exempted from the requirement to be registered in [a] jurisdiction."[3] This language could have several implications.

Notably, 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 the proposed *de minimis* exemptions in the Proposed Registration Instrument[4] (the "**Proposed Registration De Minimis Exemptions**"),[5] then the language could severely limit the efficacy of any such exemption as the costs imposed on otherwise exempt derivatives

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

[3] *See* Proposed Companion Policy at Section 1 (CSA Notice at 99).

[4] *See* CSA Notice and Request for Comment on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 (Apr. 19, 2018) ("**CSA Proposed Registration Notice**"), http://www.albertasecurities.com/Regulatory%20Instruments/5399899%20_%20CSA%20Notice%2093-102.pdf. Proposed NI 93-102 and Proposed Companion Policy 93-102 are collectively referred to herein as the "**Proposed Registration Instrument**".

[5] Proposed NI 93-102 at Section 50 and 51 (proposing de minimis exemptions from registration for derivatives dealers with a limited notional amount under derivatives and for commodity derivatives dealers with a limited notional amount under commodity derivatives, respectively).

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dealers could be significant. Specifically, even if a market participant was exempt from registering as a derivatives dealer under the Proposed Registration De Minimis Exemptions, it could still be treated as a derivatives dealer under the Proposed Instrument and, depending on its counterparties, could be subject to a litany of business conduct requirements, including obligations regarding the following with eligible derivatives parties ("**EDPs**"): fair dealing; conflict of interest management; general know-your-derivatives party; compliance and risk management systems; client/counterparty agreements; recordkeeping; and senior management.[6] The Working Group notes that some of these obligations, such as the obligations regarding recordkeeping and senior management, would impose significant burdens on some derivatives firms because of the introduction of broad, new regulatory obligations. For example, as discussed further in Section II.C. of this comment letter, the recordkeeping obligations are broad and would be significantly burdensome, particularly with respect to voice recordings.[7] In addition, as discussed further in Section II.D. of this comment letter, the Proposed Instrument would require the senior derivatives manager of each derivatives business unit of a derivatives firm to prepare a detailed report at least once a year.[8]

Given the extensive potential obligations under the Proposed Instrument that would be imposed on a derivatives dealer, the value and utility of the Proposed Registration De Minimis Exemptions would be severely undercut. As such, the Working Group urges the CSA to ensure that the Proposed Registration De Minimis Exemptions work in harmony with the Proposed Instrument. Stated another way, market participants relying on the Proposed De Minimis Exemptions should not be treated as derivatives dealers under the Proposed Instrument. This would be consistent with the approach taken in the United States by the Commodity Futures Trading Commission ("**CFTC**").[9]

B. To Ensure an Appropriately Tailored End-User Exemption, the EDP Definition Needs to Be Modified to Avoid Harming Commodity Derivatives Markets

The Working Group appreciates that the CSA included an end-user exemption from the obligations of the Proposed Instrument. However, to ensure an appropriately tailored end-user exemption, the EDP definition needs to be modified to avoid harming commodity derivatives markets.

As the CSA is aware, the Proposed Instrument would impose different regulatory requirements on market participants based on the types of counterparties with whom they transact. Specifically, the Proposed Instrument separates the derivatives market into two main groups – (i) market participants who are sophisticated or have adequate financial resources (*i.e.*, EDPs) and (ii) market participants who are less sophisticated or lack adequate financial resources (*i.e.*, non-eligible derivatives parties ("**Non-EDPs**")) – under the theory that the latter group requires extra customer protections.

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[6] CSA Notice at 23.

[7] *See* Proposed Companion Policy at Section 34 (CSA Notice at 132-33).

[8] *See* Proposed NI 93-101 at Section 31.

[9] The CFTC's business conduct rules apply to registered swap dealers and do not apply to market participants that qualify for the CFTC's swap dealer de minimis exemption. *See generally* Final Rule, *Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties*, 77 Fed. Reg. 9,734 (Feb. 17, 2012), http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-1244a.pdf.

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The Proposed Instrument uses the EDP concept in the context of (i) the proposed obligations, which, among other things, are triggered by certain interactions with Non-EDPs; and (ii) certain exemptions, including the end-user exemption,[10] which are not available if a derivatives firm deals with or advises a Non-EDP. Accordingly, the scope of the definition of EDP is an integral part of the regulatory regime contemplated in the Proposed Instrument and the Proposed Registration Instrument. As such, the Working Group appreciates that the CSA revised the EDP definition in the Proposed Instrument based on comments submitted on the EDP definition in the 2017 Proposed Business Conduct Instrument. The EDP definition in the Proposed Instrument is an improvement as it considers a separate threshold for commercial hedgers and the ability to rely upon a guarantee from certain affiliated EDPs. However, the proposed EDP definition still presents several issues, as further discussed below.

The primary issue with the current proposed definition of EDP is that the asset thresholds for certain types of entities remain too high. The Working Group understands that the general $25 million net asset threshold for companies[11] is based on the "permitted client" definition in National Instrument 31-103 and that the proposed $10 million net asset threshold for commercial hedgers[12] reflects an important difference between securities markets and derivatives markets, which are widely used to hedge commercial risk, while securities markets are not.[13]

However, the $10 million commercial hedger threshold, while an improvement, is still too high. There are material benefits to providing an EDP threshold lower than $10 million in net assets for commercial hedgers. At a conceptual level, a lower threshold will encourage risk management through the use of derivatives, which is desirable. A lower threshold may also ensure that smaller commercial market participants continue to have access to a liquid and competitive market as they have more available counterparties who are able to rely upon the exemptive relief in the Proposed Instrument that is available to market participants that transact only with EDPs. As the Working Group has previously highlighted, in the United States, imposing registration obligations and associated obligations (*e.g.*, business conduct requirements) on market participants that engage in limited dealing activity with certain types of entities may not protect such entities and may, in fact, harm them by limiting the number of available counterparties and reducing market liquidity.[14]

Commercial hedgers with less than $10 million in net assets generally do not need retail-level customer protections. The policy rationale underlying the decision to provide commercial hedgers a $10 million rather than $25 million net asset threshold is based on the degree of sophistication that smaller market participants have with respect to the risks faced in their day-to-day business. That policy rationale also underlies regulatory paradigms similar to the EDP paradigm that apply a lower (*e.g.,* less than $10 million*)* or no threshold to

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[10] *See* Proposed NI 93-101 at Section 37. In addition, one of the criteria to qualify for the proposed exemption from specific requirements in the Proposed Instrument for foreign derivatives dealers is not soliciting or transacting with a Non-EDP. *See* Proposed NI 93-101 at Section 38.

[11] *See* Proposed NI 93-101 at Section 1(1) (EDP definition ¶(m)).

[12] *See* Proposed NI 93-101 at Section 1(1) (EDP definition ¶(n)).

[13] *See* CSA Notice at 5.

[14] *See* The Canadian Commercial Energy Working Group White Paper (Attached to the Comment Letter on the 2017 Proposed Business Conduct Instrument) (Aug. 15, 2017), https://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20170815_93-101_canadian-commercial-energy.pdf (discussing issues related to "special entities"); The Canadian Commercial Energy Working Group Comments on the Proposed Registration Instrument (Aug. 2, 2018), http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20180802_93-102_canadian-commercial-energy.pdf.

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commercial hedgers. For example, various provinces' existing blanket orders (collectively, the "**Exemption Blanket Orders**"),[15] among other things, effectively exempt market participants from the obligation to register as a derivative dealer if they limit their derivatives counterparties to "qualified parties," and Section 7 of the Québec Derivatives Act takes a similar approach by excluding transactions between "accredited counterparties"[16] from consideration when determining whether an entity must register as a derivatives dealer. Both the various definitions of "qualified party" and the definition of "accredited counterparty" allow commercial hedgers to qualify as such without satisfying an asset threshold of any kind. Further, in the United States, the Commodity Exchange Act ("**CEA**") allows commercial hedgers to qualify as "eligible contract participants" (allowing them to enter into swaps) with only $1 million in net worth.[17] In each of these circumstances, regulators appear to have weighed the benefits and risks associated with treating smaller commercial hedgers in a manner similar to or the same as other sophisticated, but larger, market participants and determined that low or no "qualifying thresholds" are justified. The Working Group respectfully urges the CSA to follow that reasoning and lower the commercial hedger EDP threshold[18] to $1 million in net assets.

To the extent the CSA decides to retain the proposed $25 million general and $10 million commercial hedger EDP thresholds, the Working Group suggests for the CSA to make those thresholds based on total assets rather than net assets. If the intent of the asset thresholds is to serve as a proxy for the size and degree of sophistication of market participants, then total assets is a better metric. Total assets is a measure of the "size" of a business, while net assets is effectively a proxy for shareholders' equity. In fact, with respect to the general asset thresholds for entities in the definitions of "qualified party" and "eligible contract participant," the focus is on total assets rather than net assets, and the CSA should do the same in the Proposed Instrument.[19]

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[15] *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_/; Manitoba Securities Commission Blanket Order 91-501 *Over-the-Counter Trades in Derivatives* (Oct. 26, 2015) https://docs.mbsecurities.ca/msc/notices/en/120617/1/document.do; 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.

[16] *See* Québec 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.

[17] *See* CEA Section 1a(18).

[18] *See* Proposed NI 93-101 at Section 1(1) (EDP definition ¶(n)).

[19] *See* Alberta Securities Commission Blanket Order 91-507 *Over-the-Counter Derivatives* (Jan. 23, 2017); British Columbia Securities Commission Blanket Order 91-501 *Over-the-Counter Derivatives* (Nov. 24, 1999); Manitoba Securities Commission Blanket Order 91-501 *Over-the-Counter Trades in Derivatives* (Oct. 26, 2015); Financial and Consumer Services Commission (New Brunswick) Local Rule 91-501 *Derivatives* (consolidated up to Jan. 11, 2015); Nova Scotia Securities Commission Blanket Order 91-501 *Over the Counter Trades in Derivatives* (Feb. 17, 2016); Financial and Consumer Affairs Authority of Saskatchewan General Order 91-908 *Over-the-Counter Derivatives* (Feb. 29, 2016); CEA Section 1a(18).

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C. The Proposed Instrument's Recordkeeping Requirements Are too Broad

The Proposed Instrument's recordkeeping requirements are overly broad and likely 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.[20] The Proposed Instrument could be read to place an affirmative obligation on derivatives dealers to record phone lines as well.[21]

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]."[22] 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]."[23] 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 a 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.

D. Internal Reporting Obligations Should Be Consolidated to Avoid Duplicative Efforts and the Requirements Should Only Apply to Registered Derivatives Firms

The Working Group respectfully urges the CSA to consider streamlining the proposed internal reporting obligations that would be imposed on derivatives firms. As discussed further herein, the internal reporting obligations should be consolidated to avoid duplicative efforts, and the requirements should only apply to registered derivatives firms.

Under the Proposed Instrument, the senior derivatives manager of each derivatives business unit of a derivatives firm would be required, on at least an annual basis, to prepare a report for the board of directors stating either of the following: (i) each incidence of material non-compliance and the steps taken to respond to each such incidence; or (ii) that the

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[20] *See* Proposed Companion Policy at Section 34 (CSA Notice at 133-34).

[21] *See* Proposed Companion Policy at Section 34 (CSA Notice at 133-34).

[22] Proposed Companion Policy at Section 34 (CSA Notice at 133-34).

[23] Proposed Companion Policy at Section 34 (CSA Notice at 133-34).

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derivatives business unit is in material compliance.[24] This proposed internal reporting obligation for senior derivatives managers is similar to the proposed obligations under the Proposed Registration Instrument for derivatives chief compliance officers,[25] derivatives chief risk officers,[26] and derivatives ultimate designated persons.[27] Given the overlap of the proposed internal reporting requirements and considering the potential costs and burdens associated with such internal reporting, the Working Group requests that the CSA consolidate all the proposed annual internal reporting obligations under both the Proposed Instrument and the Proposed Registration Instrument to only one annual report.

In addition to consolidating the internal reporting obligations to one annual report, the Working Group respectfully suggests that such obligation only be imposed on registered derivatives firms for two key reasons.

First, limiting the proposed internal reporting obligation to registered derivatives firms is appropriate given that derivatives firms that are exempt from registration would still be subject to the proposed obligations to establish, maintain, and apply policies, procedures, controls, and supervision aimed at ensuring compliance.[28] As such, derivatives firms that are exempt from registration would still be subject to comprehensive obligations which would result in achieving the same regulatory objectives – protection of investors, reduction of risk, improving transparency, increasing accountability, and promoting responsible business conduct in the over-the-counter derivatives markets.[29] Given that the regulatory objectives could be achieved without imposing internal reporting obligations on derivatives firms that are exempt from registration, the Working Group respectfully requests for the CSA to make amendments to any final instrument so that the internal reporting obligation is limited to registered derivatives firms.

Second, limiting the proposed internal reporting obligation to registered derivatives firms would be consistent with the approach taken by the CFTC. Specifically, a comparable obligation under the CFTC Regulations is the chief compliance officer annual report, which is only imposed on certain registrants (*e.g.*, a registered swap dealer).[30] The tailored application of the chief compliance officer annual report to certain registrants under the CFTC Regulations, which is based on statutory requirements, reflects important policy decisions to balance the associated regulatory costs and burdens with the goal of increased oversight of market participants that may present a higher likelihood of introducing systemic risk (*e.g.*, registered swap dealers or registered major swap participants). In the Proposed Registration Instrument, the CSA recognized the importance of appropriately tailoring the application of regulatory obligations when it noted that the proposed registration requirements would be

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[24] *See* Proposed NI 93-101 at Section 31(2).

[25] *See* Proposed NI 93-102 at Section 28(3)(d) (proposing to require that the derivatives chief compliance officer submit an annual report to the board of directors, or individuals acting in a similar capacity, of a registered derivatives firm).

[26] *See* Proposed NI 93-102 at Section 29(3)(d) (proposing to require that the derivatives chief risk officer submit an annual report to the board of directors, or individuals acting in a similar capacity, of a registered derivatives firm).

[27] *See* Proposed NI 93-102 at Section 27(3)(c) (proposing to require that the derivatives ultimate designated person report, on a timely basis, to the board of directors, or individuals acting in a similar capacity, of a registered derivatives firm).

[28] *See* Proposed NI 93-101 at Section 30(1).

[29] *See* CSA Notice at 2 (discussing the purpose of the Proposed Instrument).

[30] *See* CFTC Regulation 3.3(e).

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limited to "key market participants."[31] As such, the Working Group respectfully requests for the CSA to continue this line of reasoning and limit any proposed internal reporting obligation to registered derivatives firms.

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/ Alexander S. Holtan
Alexander S. Holtan
Blair Paige Scott

[31] CSA Proposed Registration Notice at 16.

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asset management group

September 17, 2018

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*, Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration*

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**") appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the "**Business Conduct Instrument**") and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the "**Business Conduct CP**" and, collectively with the Business Conduct Instrument, the "**Business Conduct Rule**") and Proposed National Instrument 93-102 *Derivatives: Registration* (the "**Registration Instrument**") and Proposed Companion Policy 93-102 *Derivatives: Registration* (the "**Registration CP**" and, collectively with the Registration Instrument, the "**Registration Rule**")(collectively, the Business Conduct Rule and the Registration Rule, the "**Proposed Rules**").

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

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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. In their role as fiduciaries to investors and clients, AMG members use futures and cleared swaps, as well as other derivatives, for a range of purposes, including as a means to manage or hedge investment risks such as changes in interest rates, exchange rates, and commodity prices.

In transacting in derivatives for their clients, portfolio managers such as AMG members are entering into transactions with dealer counterparties on behalf of clients. The portfolio manager is not a principal in such a transaction – the risk and exposure related to the transaction lies with the dealer and the client, not the portfolio manager. Further, a portfolio manager acting on behalf of a client is governed by the client's investment mandate, which prescribes the concentration, risk, exposure, liquidity, leverage etc. limits on the client's account. The risk management systems of a portfolio manager are properly concerned with, and monitor for, limits, risks and exposure at a client account level. This contrasts with the risks and exposure of dealer firms, where the dealer itself faces risk and exposure of the transactions it enters into. It is this risk and exposure that is the more appropriate focus of business conduct and registration rules relating to derivatives.

The Proposed Rules significantly impact AMG members, including many that provide asset management services to Canadian clients on a cross-border basis. This is particularly the case given that the Proposed Rules do not include equivalents of the international sub-adviser exemption found in section 8.26.1 of NI 31-103 (the "**International Sub-Adviser Exemption**") and the international adviser exemption found in section 8.26 of NI 31-103 (the "**International Adviser Exemption**"). It is critical to our members that the Proposed Rules include exemptions mirroring the International Sub-Adviser Exemption and the International Adviser Exemption. Failing to include these exemptions in the Proposed Rules may limit the participation of foreign firms in the Canadian marketplace and therefore ultimately decrease choice and increase costs for Canadian market participants.

Given this and our below comments on the Proposed Rules, including the fact that the relevant Appendices for the exemptions available to foreign derivatives advisers under the Proposed Rules have not been made available to the public, a third round of consultation and comments on the Business Conduct Rule is necessary, as well as further consultation and comments on the Registration Rule to ensure a meaningful opportunity for comment. The transition periods for the Proposed Rules should sufficiently and fairly reflect these factors. Given that the majority of AMG members or their affiliates are non-Canadian firms, it is imperative that the Proposed Rules identify the jurisdictions that will provide a partial or full exemption in order to give market participants a sufficient opportunity to provide meaningful comments on the proposed exemptions. Because the Proposed Rules do not contain this material information, foreign firms are in a state of uncertainty as to whether they will receive, full, partial or no exemptions from the registration requirements. Without this critical information, foreign firms cannot determine how they will be impacted by the Proposed Rules and consequently, foreign firms are being deprived of the opportunity to provide meaningful comment on the Proposed Rules. Consequently, foreign firms will be forced to decide—without the benefit of important information—on the appropriate

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course of action, which may include registering in Canada or ceasing its OTC derivatives operations in Canada.

We begin our comments with introductory thoughts on the Proposed Rules, followed by our comments that apply to both Proposed Rules and concluding with separate specific comments on each of the Business Conduct Rule and the Registration Rule. We also set out in Appendix "A" our responses to certain of the matters relevant to our members that the CSA has requested specific feedback with respect to the Business Conduct Rule and in Appendix "B" our responses to certain of the matters relevant to our members that the CSA has requested specific feedback with respect to the Registration Rule.

A. Introductory comments applicable to both of the Proposed Rules

Regulating dealers and market participants in OTC derivatives, who have not been subject to the same level of regulation as securities industry market participants, is the stated focus of the Proposed Rules:

> "During the financial crisis of 2008, some firms dealing in derivatives contributed to the crisis by not effectively managing their own derivatives related risks. The International Organization of Securities Commissions (IOSCO) noted in 2012 that "historically, market participants in OTC derivatives markets have, in many cases not been subject to the same level of regulation as participants in the traditional securities market. This lack of sufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008." [*emphasis added*]

In contrast, securities advisers in Canada are, and have historically been, subject to extensive regulatory oversight.[1] Such advisers are currently subject to the requirements in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

NI 31-103 already provides an extensive, harmonized and comprehensive framework for the regulation of portfolio managers operating or conducting activities in Canada and it should remain the principal regulatory instrument for portfolio managers, even in the OTC derivatives space. Expanding the regulatory oversight of portfolio managers to the Proposed Rules is unnecessarily onerous and does not appear to be justified by any identified systemic risks created by ***portfolio managers*** in the Canadian marketplace.[2]

Further, applying the Proposed Rules will create an even more fragmented regulatory regime for portfolio managers in Canada. For instance, a foreign portfolio manager that proposes to advise an institutional client in Ontario with respect to securities, commodity futures and OTC derivatives, in reliance on registration exemptions, will have to be concerned with three separate regimes and three different sets of exemptions.[3]

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[1] In this letter, we use the term "portfolio manager" to refer to advisers registered or exempt under NI 31-103 and applicable commodity futures legislation (as context dictates).

[2] Notably and as cited in this letter, the implementation of the Proposed Rules is premised on risks created by dealers and market participants in OTC derivatives that have not been subject to the same level of regulation as securities industry market participants.

[3] These exemptions include: (i) in NI 31-103, the International Adviser Exemption and the International Sub-Adviser Exemption; (ii) under the *Commodity Futures Act* (Ontario) (the "**CFA**"), the discretionary exemptions that mirror the

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Any exemptions in the Proposed Rules should mirror the existing rules pertaining to the International Adviser Exemption and the International Sub-Adviser Exemptions. Not only do the Proposed Rules not mirror the existing international exemptions, they fail to identify which jurisdictions are fully exempt from registration as well as those jurisdictions that are partially exempt and they introduce conditions that have not generally been seen in the Canadian securities regulatory landscape, including creating a new investor status and requiring registration in the relevant home jurisdiction, substituted compliance and notification to regulators of material non-compliance matters). The requirement for a firm to be registered in its home jurisdiction is particularly challenging for SEC-registered investment advisers, which are able to use derivatives in certain situations, while being exempt from the CFTC's Commodity Trading Advisor registration requirements.

This lack of harmonization with existing securities exemptions, combined with the proposed compliance requirements of the exemptions, may reduce the number of foreign portfolio managers willing to provide advisory services to Canadian clients and may reduce the amount of derivatives trading activity in Canada, thereby reducing liquidity.

For these reasons, we believe that the CSA must re-evaluate each of the following issues prior to its consideration of finalizing the Proposed Rules:

- The Proposed Rules should not apply to registered portfolio managers because they are already sufficiently regulated;

- Requiring comment on either the full or partial exemptions for foreign derivatives firms, as well as on various other parts of the Proposed Rules that have not been fully determined, deprives the CSA of the benefit of informed comment on those issues;

- The Proposed Rules deviate from international standards and risk harming cross-border activity, including reducing cross-border liquidity into Canada;

- To the extent that portfolio managers advising on OTC derivatives pose an identified and significant risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks instead of adding a new, separate regulatory regime under the Proposed Rules;

- The Proposed Rules (to the extent that they will apply to portfolio managers) should only impose the fundamental obligations found in Part 3 Division 1 of the Business Conduct Rule on portfolio managers (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party);

- To avoid cross-border issues and to improve harmonization, NI 31-103, or alternatively, the Proposed Rules (to the extent that they will apply to portfolio managers), should include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption; and

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conditions of the International Adviser Exemption and the International Sub-Adviser Exemption; and (iii) the foreign derivatives adviser exemptions available under the Proposed Rules, which do not mirror the conditions of International Adviser Exemption and the International Sub-Adviser Exemption.

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- The Proposed Rules should not adopt a new investor status in the "eligible derivatives party" definition and should not create new material reporting thresholds in the foreign adviser exemptions; instead, the Proposed Rules should apply the concepts already existing in the securities space.

While we have not commented on the specific dealer requirements in the Proposed Rules, we ask that you refer to the comments and concerns raised by dealers – to the extent that there are fewer dealers with whom advisers may transact as a result of the Proposed Rules, advisers will have difficulty in hedging risk and providing liquidity for their Canadian clients.

B. Comments applicable to both of the Proposed Rules

Application of the Proposed Rules to Portfolio Managers

1. Applying a new regime to portfolio managers is duplicative, unnecessary and unduly burdensome

Portfolio managers are already subject to extensive regulation. For instance, portfolio managers registered under NI 31-103 must establish and maintain significant policies, procedures and controls to manage the risks of their businesses and ensure compliance with securities legislation. The roles of a registered Ultimate Designated Person and a registered Chief Compliance Officer already exist to oversee portfolio managers' compliance systems. Each individual engaged in advising activities with the firm are already subject to registration requirements as well. Further, portfolio managers are already required to maintain minimum levels of capital, maintain extensive books and records, provide fulsome disclosure and reporting to clients, ensure fairness in allocating investment opportunities among clients, appropriately manage conflicts of interests and client complaints and avoid certain conflicted transactions, among other obligations, including maintaining insurance. In addition, portfolio managers that advise on exchange-traded derivatives are also subject to additional regulation in certain provinces under commodity futures legislation.

Layering additional yet largely duplicative regulation on portfolio managers that advise on OTC derivatives is unnecessarily burdensome and not in line with international standards, particularly those found in the United States. It is also out of step with recent regulatory burden reduction efforts by the CSA (for instance, see CSA Staff Notice 81-329 *Reducing Regulatory Burden for Investment Fund Issuers*).

2. Registered portfolio managers should be fully exempted from the application of the Proposed Rules and, to the extent that portfolio managers advising on OTC derivatives pose an identified risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks

Given the considerations above, registered portfolio managers should be fully exempted from the Proposed Rules. Otherwise, registered portfolio managers, in order to avoid the onerous application of the Proposed Rules, may limit their clients' access to certain OTC derivatives in Canada. The Proposed Rules may also drive foreign portfolio managers out of the Canadian marketplace, likely resulting in reduced investor choice in Canada and increased costs for both investors and Canadian firms.

To the extent that the CSA believes that portfolio managers, either registered or exempt, advising on OTC derivatives pose a residual risk to Canadian capital markets, appropriate revisions should be made to NI

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31-103 to address such risks. For instance, the International Adviser Exemption and the International Sub-Adviser Exemption can be modified to be made available to foreign portfolio managers advising on OTC derivatives.

The "incidental" guidance in the Business Conduct CP and the Registration CP does not address these concerns. Such guidance is vague, difficult to apply in practice and does not provide sufficient clarity for market participants in determining whether they are subject to the registration requirement. Clear exemptions in each Proposed Rule is our preferred approach.

We also have a concern with respect to the product scope of the Proposed Rules. We understand that the Proposed Rules will apply to persons in the business of dealing in or advising on instruments as determined by the relevant derivatives product determination rule in each province and territory (the "Product Determination Rules"). Under the Product Determination Rules, foreign exchange contracts are "in scope" and therefore would be "in scope" for the purposes of the Proposed Rules.

Assuming that the Proposed Rules will apply to portfolio managers, the CSA should consider the instruments caught by the Product Determination Rules for the purposes of the Proposed Rules. In particular, foreign exchange contracts should not be "in scope" for the purposes of the Proposed Rules – these contracts do not present a systemic risk to Canadian capital markets. Foreign exchange contracts are commonly used by portfolio managers to hedge risks associated with their clients' investment portfolios (a necessary incidental aspect of managing a securities portfolio) and this activity should not subject a portfolio manager to the Proposed Rules.

The CSA contemplated that the application of the Product Determination Rules could vary depending on the particular regulatory instrument under consideration. For instance, the following is stated in CSA Consultation Paper 91-301 – *Model Provincial Rules – Derivatives Product Determination and Trade*:

> "The Committee expects that elements of the Scope Rule, subject to necessary amendments, will also be made applicable to certain provisions of securities legislation, and to additional derivatives rules that will be brought into force, including but not limited to rules relating to over-the-counter central counterparty clearing, end-user exemptions, trading platforms, capital and collateral, and registration. However, there may be variations in the application of the Scope Rule for these other rules. In particular, certain contracts or instruments that are prescribed to be securities or derivatives for the purposes of the TR Rule may be treated differently in other rules." [emphasis added]

3. *If portfolio managers are not fully exempted from the application of the Proposed Rules and NI 31-103 is not modified, then portfolio managers should only be subject to the fundamental requirements in Part 3 Division 1 of the Business Conduct Rule*

If portfolio managers are not fully exempted from the application of the Proposed Rules, then they should only be required to comply with the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party).

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Application of the Proposed Rules to Foreign (Exempt) Portfolio Managers

We propose that NI 31-103, or alternatively, the Proposed Rules (to the extent that they will apply to portfolio managers), should simply include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption.

1. *The foreign derivatives adviser exemptions in the Proposed Rules are overly burdensome and not sufficiently harmonized with existing international exemptions available under NI 31-103*

Section 43 of the Business Conduct Rule and Sections 59 and 61 of the Registration Rule provide exemptions for foreign derivatives advisers from the Proposed Rules if certain conditions are met, including that the foreign derivatives adviser is subject to, and in compliance with, the laws of a specified foreign jurisdiction (to be set out in an appendix to each rule). Other conditions of certain of these exemptions include that the foreign derivatives adviser promptly notifies the applicable Canadian regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction. A foreign derivatives adviser relying on one of these exemptions must still comply with certain of the requirements of the Proposed Rules, despite being subject to the regulation of the foreign jurisdiction.

For no clearly identified reason, the exemptions under the Proposed Rules are much more limited than the International Adviser Exemption and the International Sub-Adviser Exemption, as well as the corresponding discretionary exemptions under commodity futures legislation.

Further, these exemptions are premised on the concept of substantial compliance, which is a novel concept in the Canadian securities regulatory landscape, as is the requirement to notify the applicable Canadian regulator of instances of material non-compliance. Despite the guidance provided, this notification requirement is overly broad. With respect to the foregoing, we encourage the CSA to build in the following concepts:

(i) Notification should only be required if the matter giving rise to the non-compliance is material to, and affects, Canadian clients serviced under the relevant exemption;

(ii) It should be clear that notification to the Canadian securities regulators is to be given only after notification has been given to the foreign firm's regulator in its home jurisdiction; and

(iii) The form of filing that the foreign firm used in its home jurisdiction should be accepted by the CSA (e.g. if the matter required an update to a firm's Form ADV that was filed with the SEC, then the firm should be able to file the updated Form ADV as its notification to the Canadian securities regulators).

For these reasons, NI 31-103 or alternatively the Proposed Rules (to the extent that they will apply to portfolio managers) should include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption. One appropriate outcome we see from this approach is that an SEC-registered investment adviser whose principal office is outside of Canada would not be subject to the Proposed Rules when it provides investment advisory services which include OTC derivatives to Canadian funds and clients that are eligible derivatives parties. This outcome would be consistent with the approach to securities regulation under NI 31-103.

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Finally, we reiterate that it is difficult to comment on the appropriateness of the foreign derivatives adviser exemptions in the Proposed Rules because the appendices of foreign jurisdictions have yet to be identified for comment. Foreign firms are not able to fully and properly assess how the Proposed Rules will apply to them, as they do not yet know the full extent of the requirements to which they will be subject. A process should also be built into each appendix to update the list of acceptable foreign jurisdictions in an efficient manner (with appropriate industry consultation and comment process) to avoid the appendices becoming static. This is important as regulation constantly evolves, often at a quick pace. A third round of consultation and comments on the Business Conduct Rule is necessary, as well as further consultation and comments on the Registration Rule.

2. The International Sub-Adviser Exemption should be available to firms with respect to OTC derivatives activities

It is critical that an equivalent of the International Sub-Adviser Exemption be available to firms with respect to OTC derivatives activities. It defies market efficiency and notions of cross-border harmonization to require a firm that is exempt from registration in Canada under the International Sub-Adviser Exemption for securities law purposes to have to both register as a derivatives adviser, and be subject to extensive business conduct requirements, simply for sub-advising on a mandate that includes OTC derivatives. The application of the International Sub-Adviser Exemption to OTC derivatives activities would help to address our harmonization concerns, as well as our concerns with respect to the compliance burdens. Failing to include such an exemption may also severely limit the participation of foreign firms in the Canadian marketplace.

The terms of the International Sub-Adviser Exemption available to firms with respect to OTC derivatives activities should be identical to the terms found in section 8.26.1 of NI 31-103. Therefore, if a firm qualifies under the International Sub-Adviser Exemption, it should not be subject to further Canadian securities regulatory requirements. This is justifiable from a policy perspective, as an international sub-adviser may only advise a registered Canadian adviser or dealer, specifically where that registered firm has agreed to be responsible for the losses arising out of the failure of international sub-adviser to fulfill its fundamental obligations.

3. The International Adviser Exemption should be available to firms with respect to OTC derivatives activities

Similarly, an equivalent of the International Adviser Exemption should be available to firms with respect to OTC derivatives activities. The terms of the International Adviser Exemption should mirror the terms found in section 8.26 of NI 31-103. No policy reason has been identified why such an exemption should not be available to firms that advise on OTC derivatives. Adopting such an approach promotes cross-border harmonization and marketplace efficiency.

4. If the International Sub-Adviser Exemption and the International Adviser Exemption are not available to firms with respect to OTC derivatives activities, then foreign derivatives advisers should only be subject to the fundamental requirements in Part 3 Division 1 of the Business Conduct Rule

If the International Sub-Adviser Exemption and/or the International Adviser Exemption are not included in NI 31-103 or the Proposed Rules, then foreign portfolio managers, who may be able to avail themselves

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of the foreign derivatives adviser exemptions in the Proposed Rules, should only be required to comply with the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party).

Specifically, section 61 of the Registration Rule should be deleted in its entirety and section 59 of the Registration Rule and section 43 of the Business Conduct Rule should be modified to reflect that only the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule apply to foreign derivatives firms relying on such exemptions.

Transition Periods Must Provide a Fair and Reasonable Opportunity for Derivatives Firms to Comply

Given that it is not yet clear what final obligations and requirements will apply to portfolio managers under the Proposed Rules, it is very difficult for us to comment on the reasonableness of the proposed one year transition period in the Business Conduct Rule. This is particularly true for portfolio managers in foreign jurisdictions yet to be identified in appendices to be published in the future. Given this, a one year transition period is not reasonable. Once the final obligations and requirements are known, we will be in a better position to comment on the appropriate length of the transition periods, one that will provide our members sufficient time to meet any new applicable requirements in the Proposed Rules.

C. Specific comments with respect to the Business Conduct Rule

As those foreign jurisdictions have yet to be identified for "substituted compliance" purposes, SIFMA AMG believes that the Business Conduct Rule should be published for a further comment period. SIFMA AMG may have additional comments on any future publications.

1. Derivatives Advisers should not be required to provide relationship disclosure information and tied selling disclosures or derivatives party statements

The requirements in section 17 and section 18 of the Business Conduct Rule should not apply to derivatives advisers because derivatives advisers that are registered portfolio managers are already subject to similar obligations under NI 31-103. These obligations will also result in unnecessarily duplicative information being provided to derivatives parties by derivatives advisers and derivatives dealers because where an adviser transacts in derivatives on behalf of its investor client, the transaction is executed between the investor and the dealer, not the derivatives adviser. Therefore, derivatives dealers are the appropriate entity to provide this information to derivatives parties.

Likewise, Section 28 of the Business Conduct Rule should not apply to derivatives advisers because derivatives advisers that are registered portfolio managers are already subject to similar obligations under NI 31-103. This obligation will also result in duplicative information being provided to derivatives parties by derivatives advisers and derivatives dealers because where an adviser transacts in derivatives on behalf of its investor client, the transaction is executed between the investor and the dealer, not the derivatives adviser. Therefore, derivatives dealers are the appropriate entity to provide this information to derivatives parties.

2. Division 2 – Derivatives party assets should be modified to take into account industry practice with respect to rehypothecation of collateral and margin

We have concerns with the CSA's approach to collateral generally and in the Business Conduct Rule in particular. Section 23 specifically contemplates an exception from the application of Division 2 if a

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derivatives firm is subject to, and complies with, National Instrument 81-102 *Investment Funds* **("NI 81-102**") in respect of derivatives party assets. We also note that the recent custody amendments to NI 31-103 have introduced similar rules with respect to collateral and margin applicable to registered firms.

OSC Staff have concluded in the past that rehypothecation of collateral deposited by an investment fund with a counterparty is generally not permitted under NI 81-102, without distinguishing between variation and initial margin. In accordance with industry practice and prior advice from OSC staff, many investment funds take the position that variation margin is not subject to the collateral rules in NI 81-102 and that rehypothecation is permitted. This position should be clarified in all applicable rules, including NI 81-102 and NI 31-103.

We believe that the future rule dealing with margin and collateral requirements for non-centrally cleared derivatives is the more appropriate instrument to address collateral and margin requirements.

3. We continue to have serious concerns with the requirement for derivatives firms to have senior derivatives managers

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 activities. This requirement does not exist on the securities side in Canada. While certain major jurisdictions, such as the United Kingdom, have a role similar to that of the senior derivatives manager, it is important to keep in mind the unique Canadian regulatory environment. Unlike the United Kingdom, NI 31-103 (and the Registration Rule) prescribe (or will prescribe) categories that require firms to register individuals in oversight and compliance roles. In such a regulatory environment, it is unduly onerous and unnecessarily duplicative to then require a firm to designate an additional un-registered individual who fulfils substantially the same role as these registered individuals.

To the extent that these multiple overlapping roles are maintained in the Proposed Rules, a Canadian derivatives adviser that is an affiliate of a global/foreign derivatives adviser, which maintains individuals in some of the proposed roles who act on a global basis, should be able to rely on such individuals to meet the requirements of the Proposed Rules.

D. Specific comments with respect to the Registration Rule

As the Proposed Rules have yet to identify which foreign jurisdictions satisfy "substituted compliance," foreign advisers have not been adequately informed as to which provisions of the Registration Rule they will be subject, SIFMA AMG may have additional comments on the next publication for comment of the Registration 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, Jason Silverstein at 212-313-1176 or jsilverstein@sifma.org, or Andrew Ruggiero at 212-313-1128 or aruggiero@sifma.org.

Respectfully submitted,

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Appendix "A"

Specific Feedback on the Business Conduct Rule

Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Response: SIFMA AMG reiterates that it is important that the definition of "eligible derivatives party" include all persons and entities that qualify as "permitted clients" under NI 31-103. We do not believe a justification has been identified for excluding any category of "permitted client" from the definition of eligible derivatives party. A burden is imposed on the market by creating another investor status essentially identical to an existing one. We strongly urge that a new paragraph should be added to the definition of "eligible derivatives party" in each Proposed Rule that refers to the definition of "permitted client" under NI 31-103.

Further, specific knowledge and experience requirements should not apply in order for persons to qualify as eligible derivatives parties. This is not in line with international standards and will make it onerous for firms to onboard clients. We believe financial thresholds are sufficient to identify derivatives parties who are not in need of extra protections.

We also believe that the CSA should reconsider the $25 million net asset threshold in paragraph (m)(ii) of that definition and lower such threshold to $10,000,000. 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. This would help to address cross-border harmonization concerns and help to ensure that Canadian market participants are not placed at a competitive disadvantage.

Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

Response: No, the obligations in section 16 should not apply to eligible derivatives parties and should not apply to any foreign derivatives adviser relying on an exemption from the Business Conduct Rule. Further, the obligations in section 16 should not apply to registered portfolio managers, who are subject to the complaint handling obligations in NI 31-103.

Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.

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Response: We are concerned that the regulatory burden associated with this new requirement will reduce the number of foreign portfolio managers willing to provide advisory services to Canadian clients. To that end, foreign derivatives advisers relying on an exemption from the Business Conduct Rule should not be subject to this requirement. Further, this obligation should not apply to registered portfolio managers, who are subject to the obligations in Part 11 of NI 31-103. Portfolio managers, both Canadian and foreign, are subject to extensive regulation, including the requirement to have appropriate policies, procedures and controls in place.

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Appendix "B"

Specific Feedback on the Registration Rule

1) Methodology for determining "notional amount"

Annex I describes two different methodologies for determining notional amount for derivatives that reference a notional quantity (or volume) of an underlying asset: (i) the methodology based on the CDE Guidance, set out in Column 1 of Annex I, and (ii) the Regulatory Notional Amount methodology set out in Column 2 of Annex I.

(a) Please provide any comments relating to the constituent elements (price, quantity, etc.) of the proposed methodologies.

(b) Please provide comments on the most appropriate approach to determining the notional amount, for the purpose of regulatory thresholds, of a derivative with a notional amount schedule, including a schedule with notional amounts not denominated in Canadian dollars.

(c) Please provide comments on the most appropriate approach to determining notional amount for a multi-leg derivative.

For example, in a multi-leg derivative with multiple legs that are exercisable, deliverable or otherwise actionable and that are not mutually exclusive, is it appropriate to determine the notional amount for the derivative by summing the notional amount for each such leg that is exercisable, deliverable or otherwise actionable and that is not mutually exclusive?

Other multi-leg derivatives may have multiple legs that are not exercisable, deliverable or otherwise actionable or that are mutually exclusive. For these types of multi-leg derivatives, is it appropriate to determine the notional amount for the derivative by using a weighted average of the notional amount of each such leg that is not exercisable, deliverable or otherwise actionable or that is mutually exclusive?

(d) Please provide any general comments on determining notional amount for the purpose of regulatory thresholds, including relating to implementation of the proposed methodologies.

Response: The "notional amount" methodology that is ultimately adopted for purposes of the Registration Rule may not necessarily be appropriate in other contexts or rulemakings. The appropriate methodology for determining "notional amount" should be tailored to the specific rule in which it is applied, with appropriate industry consultation prior to introduction of the methodology in that rule.

Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Response: Please see the response above in Appendix "A".

Application of the derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation

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Under the Proposed Instrument, a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others in derivatives will be required to register as a derivatives adviser unless an exemption from registration is available.

We understand that a registered adviser under securities or commodity futures legislation may provide advice in relation to derivatives or strategies involving derivatives, or may manage an account for a client and make trading decisions for the client in relation to derivatives or strategies involving derivatives. If the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities, we may consider the registered adviser/portfolio manager to not be "in the business of advising others in relation to derivatives".

> **(a) Do you agree with this approach? If not, why not? Alternatively, should we consider including an express exemption from the derivatives adviser registration requirement for a registered adviser under securities or commodity futures legislation? If yes, what if any conditions should apply to this exemption?**
>
> **(b) When should the provision of advice by a registered adviser/portfolio manager in relation to derivatives be considered incidental to the performance of their activities as a registered adviser/portfolio manager? What factors should we consider in distinguishing between registered advisers who need to register as derivatives advisers from registered advisers that do not need to register as derivatives advisers?**

Response: We have addressed this comment extensively in the body of our comment letter above. Portfolio managers should be exempt from the application of the Proposed Rules. In particular, please refer to "Section B. Comments applicable to both of the Proposed Rules - 1. Applying this new regime to portfolio managers is unnecessary and 2. Registered portfolio managers should be fully exempted from the application of the Proposed Rules and, to the extent that portfolio managers advising on OTC derivatives pose an identified risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks" above.

Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives

Subsection 16(3) and subsection 16(4) provide an exemption from the requirement to register an individual as a derivatives dealing representative or as a derivatives advising representative in certain circumstances. Are the exemptions appropriate? In subparagraph 16(4)(b)(iii), individuals that act as an adviser for a managed account are not eligible for the exemption from the requirement to register as a derivatives advising representative. Is this carve out appropriate where an individual has discretionary authority over the account of an eligible derivatives party?

Response: SIFMA AMG supports the inclusion of these exemptions. Consistent with the removal of subsection 7(3) from the initial version of the Business Conduct Rule, which required managed accounts of eligible derivatives parties to be treated as those of non-eligible derivatives parties, subparagraph 16(4)(b)(iii) should be removed from the Registration Rule.

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Specific proficiency requirements for individual registrants

Subsections 18(2) through (6) of the Instrument establish specific proficiency requirements for each individual registration category. Are these specific requirements appropriate? If not what specific exams, designations or experience are appropriate?

Response: The specific proficiency requirements for each individual registration category should be aligned with the corresponding specific proficiency requirements found in NI 31-103. In the alternative, individuals currently registered under securities or commodity futures legislation should be grandfathered under any new requirements under the Registration Rule.

Derivatives ultimate designated person

Subparagraph 27(3)(c)(i) requires a derivatives firm's ultimate designated person to report any instance of non-compliance with securities legislation, including the Instrument, relating to derivatives or the firm's risk management policies if the non-compliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?

Response: No. This requirement is out of step with the obligations of the ultimate designated person under NI 31-103. It is not clear to us why this requirement would be introduced for firms dealing in or advising on OTC derivatives when it is not required for firms dealing in or advising on securities.

Requirements, roles and responsibilities of ultimate designated persons, chief compliance officers and chief risk officers

Sections 27 through 29 of the Instrument establish requirements, roles, and responsibilities of individuals registered as the ultimate designated person, the chief compliance officer and the chief risk officer for each registered firm. Considering the obligations imposed on senior derivatives managers in the Business Conduct Instrument, are the requirements, roles and responsibilities in sections 27 through 29 of the Instrument appropriate?

Response: Foreign advisers with a small number of Canadian clients will be reluctant to incur the cost and complexity of implementing such a regime, and hiring required individuals for these overlapping roles, solely for Canadian activities. Further, this additional compliance overlay is inappropriate for portfolio managers, which will be arranging for transactions through dealers, which are or will be required to have such personnel. Applying similar requirements to portfolio managers creates unnecessary duplication. Please also see the body of our response where we express concerns with these multiple overlapping roles under "Section C. Specific comments with respect to the Business Conduct Rule - 4. We continue to have serious concerns with the requirement for derivatives firms to have senior derivatives managers".

Minimum requirements for risk management policies and procedures

Section 39 sets out the minimum requirements for risk management policies and procedures. Are any of the requirements inappropriate? Are the requirements for an independent review of risk management systems appropriate?

Response: The requirement that risk management policies and procedures be approved by the derivatives firm's board of directors, or individuals acting in a similar capacity for the firm, is inappropriate. While we acknowledge that this requirement is similar to what swap dealers are subject to in the United States, it

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is inappropriate as directors do not have the necessary qualifications or experience to assess such policies and procedures. To meaningfully meet this requirement, the directors would have to be risk management professionals. Directors, very likely being non-risk management professionals, will have to extensively consult the firm's risk management personnel to be in a position to meaningfully review and approve these policies and procedures. The board's role should properly be to ensure that an appropriate risk management system is in place and supervise this system (receiving regular reports from appropriate risk management personnel) but it should not be to approve risk management policies and procedures. Directors do not have the experience or expertise to appropriately provide such approval. The review and approval of risk management policies and procedures is the proper domain of risk management professionals, who have the necessary experience and expertise to conduct such a review.

The requirement for an independent review of risk management systems is unnecessary as firms will update and review such systems when appropriate (given their internal risk management processes and business and operating environment) and in line with their general duties and obligations, including to clients. This requirement is also out of line with the requirements applicable to compliance systems generally (i.e., there is no requirement for an independent review of compliance systems).