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March 17, 2022

VIA 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

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Re: CSA Notice and Third Request for Comment – Proposed National Instrument 93-101 Derivatives: Business Conduct and Proposed Companion Policy 93-101CP Derivatives: Business Conduct (collectively, the "Proposed Instrument")

The Canadian Advocacy Council of CFA Societies Canada[1] (the "CAC") appreciates the opportunity to provide the following general comments on the Proposed Instrument and respond to certain of the specific questions posed.

[1] The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 19,000 Canadian CFA Charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

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 178,000 CFA Charterholders worldwide in over

We understand that changes to the Proposed Instrument from prior drafts were made to streamline the operationalization of its requirements, and ensure that access to derivatives products will not be unduly limited in the Canadian OTC derivatives markets, as well as to ensure that costs will stay competitive. As noted in our comment letter in response to the 2018 proposed amendments, we support the principles behind the business conduct proposals which include reducing systemic risk and meeting IOSCO's statement of related principles and objectives.

We believe that many of the provisions of the Proposed Instrument are improvements over the prior proposals and are responsive to comments and concerns raised by market participants. The focus on maintaining liquidity for the Canadian marketplace is quite important given the structure of OTC derivatives markets and the limited number of dealers and active counterparties in certain instrument types.

We are highly supportive of the ability for registered advisers to leverage their existing compliance infrastructure by complying with corresponding requirements in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") with respect to their derivatives activity for many of the conduct provisions set out in the Proposed Instrument, and appreciate related changes from prior proposals in response to our comments.

The newly revamped exemptions for foreign entities dealing with Canadian counterparties are also welcome, such that participants will not have to duplicate equivalent requirements of other regulatory regimes. Utilizing concepts and definitions that are familiar to those operating in other jurisdictions, chiefly the U.S. market, will also assist market participants and reduce the regulatory burden of familiarizing themselves with an entirely new set of rules.

While we have a few minor comments with respect to strengthening some of the gatekeeper obligations through the use of the senior derivatives manager mechanism and further study in the future with respect to the inclusion of some concepts from the Client Focused Reforms, we believe it is important that the final instrument be implemented and operationalized as soon as possible. It has been 14 years since the global financial crisis of 2008 precipitated a review of OTC derivatives regulation and related systemic risk concerns, and finalizing these critical regulatory responses is arguably overdue. While the Proposed Instrument is now more interoperable with developments in the OTC derivatives markets over the last number of years, the markets are continually evolving and it is important to put in place core business conduct obligations as soon as possible, acknowledging that further tweaks will likely be necessary in future.

We found that 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,*

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160 markets. CFA Institute has nine offices worldwide and there are 160 local member societies. For more information, visit www.cfainstitute.org.

Exemptions and Ongoing Registrant Obligations" was very helpful for our analysis. It could help registrants and participants in the derivatives markets to include a similar chart for reference in the Companion Policy to NI 93-101 going forward.

We wish to respond to certain of the specific questions posed in the consultation below.

Responses to Specific Questions

3) Foreign Derivatives Dealer Exemption—Requirements

We have clarified that if the person or company that is a derivatives dealer is not located in the local jurisdiction (i.e., a foreign derivatives dealer), the obligations in the Instrument apply only to its dealing activities with a derivatives party that is located in the local jurisdiction. We have further clarified that any reports made by a foreign derivatives dealer to the regulator or securities regulatory authority under section 38(1)(d) are limited exclusively to the derivatives activity being conducted with a derivatives party located in Canada.

Do you support limiting the reports to the regulator contemplated by section 38(1)(d) to only cover a foreign derivatives dealer's activities with a derivatives party that is located in Canada?

We support limiting the reporting obligations as suggested; it appears to be reasonable to limit the scope of reporting to activities involving parties located in Canada to remain interoperable with the rules of other applicable jurisdictions and avoid duplicative reporting. Some consideration of whether the transaction is with a foreign subsidiary of a domestic party that has not otherwise triggered an equivalent reporting obligation under the foreign subsidiary's applicable regulatory regime could be considered to ensure the uniform reporting of transaction activity relating to ultimate domestic derivatives exposure.

4) Commercial Hedger Category of the "Eligible Derivatives Party" (EDP) Definition

We have eliminated the $10 million financial threshold in the non-individual commercial hedger category of the definition of "eligible derivatives party" (in section 1(1) paragraph (n) of the Instrument). This means that more firms may qualify as eligible commercial hedgers under the Instrument. It is important to note, however, that, for a person or company to qualify as an eligible commercial hedger, they must provide a written waiver of their right to receive all or some of the additional protections in the Instrument (these are the additional protections that apply to all transactions with persons or companies that do not qualify as EDPs). Additionally, for a person or company to qualify as an eligible commercial hedger, they must still provide specific representations that they have the requisite knowledge and experience to evaluate certain derivatives information, as well as the suitability and characteristics of the derivative that is being transacted.

Do you support eliminating the $10 million financial threshold for qualifying as a commercial hedger? Will this new approach have any effect, positive or negative, on the ability of non-EDP clients to access liquidity from dealers or on a dealer's willingness to trade with non-EDP clients?

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We do not have a strong view as to whether the $10 million financial threshold for qualifying as a commercial hedger is the appropriate quantum. We recognize it may be difficult to come up with a definitive bright line test as the appropriate amount may vary by commercial business type and attendant risks for hedging. **However, we are concerned that removing a financial threshold altogether may lead to potential negative externalities and incentivize problematic behaviour.** While we have often stated that financial assets are not necessarily a proxy for financial sophistication, removing the financial threshold in the case of OTC derivatives may lead certain employees of dealers or intermediaries to erroneously help their clients conclude that they indeed have the requisite knowledge and experience to transact in OTC derivatives (even if leading clients to such a conclusion is done with good intentions), when in fact they are not sufficiently sophisticated and may introduce new risks that are poorly understood to their business rather than mitigating those existing from their commercial activities. As an example, with the elimination of this financial threshold, a small business owner may be more easily persuaded that they have interest rate risk and attendant hedging needs and enter into costly and questionably appropriate OTC derivatives transactions as a commercial hedger as a result. We would strongly argue that associated transaction activity limited to smaller quantum is unlikely to attract the most scrupulous of OTC derivatives dealers and employees, and question the attendant pricing efficiency that will be available to these erstwhile commercial hedgers. We believe this is an opening to inappropriate or even coercive client qualification as a commercial hedger and related transactional activity, and is likely to lead to mis-selling and wider misconduct.

Prior to accepting any such self-declaration from a prospective commercial hedger, it will be critical for the derivatives dealer to have an obligation of extensive additional due diligence on the client, particularly in cases of small client size and lacking a professionalized hedging function and related personnel. Additional guidance in the companion policy to the Proposed Instrument should be provided with respect to the appropriate due diligence for illustrative client profiles (especially when self-certifying as a small commercial hedger), but it might include as a minimum ensuring the client (or their personnel as appropriate) has a thorough understanding of the pricing and financial terms of the derivative types in question, as well as the client's history of prior derivative transactions and their appropriateness in relation to their hedgable business risks. In addition, the written waiver of their right to receive all or some of the additional protections in the Proposed Instrument should be required to be carefully explained to the client, and contain prescriptive bold-face warnings and documentation similar to those found in documentation requirements for transacting in exempt market securities for individual accredited investors. Unlike the typical written waiver provided by permitted clients to securities dealers and advisers under NI 31-103 where the client waives the suitability determination, all of the rights and protections that are being relinquished should be clearly set out in prescriptive plain language terms in the waiver and require individual client affirmations for each major term or warranty. Some prescription of the form and content of the waiver would also be welcome.

Any derivative firm that has clients waiving their rights as commercial hedgers should be required to have rigorous supervision requirements with respect to those transactions and related client documentation, including evidence of client due diligence and any waivers.

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5) *Exemptions from the Designation and Responsibilities of a Senior Derivatives Managers*

We have added exemptions in section 31.1 of the Instrument from the senior derivatives manager requirements for persons and companies to rely on (i) a general de minimis exemption available to all derivatives dealers whose aggregate gross notional amount of outstanding derivatives does not exceed $250 million or (ii) a de minimis exemption available to derivatives dealers that exclusively deal in commodities derivatives and whose aggregate gross notional amount of outstanding commodity derivatives does not exceed $3 billion.

Do you support the additional exemptions in section 31.1 from the senior derivatives manager requirements?

We are not currently in support of these additional exemptions, and believe that presentation of additional information on the impetus for this change (including any cost-benefit analysis) and related research is required for us to confirm that either of the proposed *de minimis* exemptions are appropriate in form and related quantum. While we don't have a comment on the specific proposed amount of aggregate gross notional amount of outstanding derivatives below which a senior derivatives manager would not be required, we have concerns that removing this requirement could have attendant gatekeeper risks, and again attract further risk of oversight failures and/or misconduct particular to this smaller dealer segment.

As noted in the proposed companion policy, a senior derivatives manager is primarily responsible for a particular derivatives business unit, and they will manage or have significant influence over its activity on a day-to-day basis, including with respect to the conduct of the unit. Any such, broad exemption provides an opportunity for significant counterparty damage, particularly for lesser sophisticated parties that transact without close supervision from experienced personnel. While the macroprudential considerations relating to these changes made in the Proposed Instrument from prior iterations are certainly important, the gatekeeper function performed by roles such as a senior derivatives manager cannot be overlooked, as it may lead to conduct and oversight failures and loss of market and counterparty confidence in smaller derivatives dealers and related less liquid derivatives markets.

6) *Short-Term FX Contracts in the Institutional FX Market*

We have applied a limited subset of provisions in section 1.1 of the Instrument to any Canadian financial institution that is a derivatives dealer with respect to its short-term FX transactions in the institutional FX market (commonly referred to as 'FX spot' in the 'wholesale FX' market) if its gross notional amount of derivatives outstanding exceeds $500 billion. This provision is only intended to capture those transactions between such derivatives dealers and their counterparties that are also considered wholesale FX market participants for the purposes of the FX Global Code of Conduct.

Do you support applying the specified provisions to this subset of derivatives dealers?

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We support applying this specific subset of provisions to Canadian financial institutions that are derivative dealers and the subset of transactions with these counterparties. We agree that these dealers should be required to abide by the core business conduct rules in the Proposed Instrument relating to fair dealing and conflicts of interest, and do not believe that exempting them from other provisions introduces any additional risk to the FX spot market.

7) Treatment of Registered Advisers under Securities or Commodity Futures Legislation

We have added an exemption in section 45 for registered advisers under securities or commodity futures legislation from certain requirements of the Proposed Instrument listed in Appendix E if the registered adviser complies with corresponding requirements in NI 31-103 relating to a transaction with a derivatives party. In such cases, we anticipate that the existing compliance systems of the registered adviser can easily be extended to address any of the residual obligations of the Instrument, which residual obligations ensure that NI 31-103 requirements are extended to the registered adviser's derivatives activities.

Please provide any comments you may have on this approach and the requirements listed in Appendix E.

We understand that some derivatives parties rely on the expertise of a derivatives adviser to develop or implement derivatives trading strategies to help them achieve their organizational objectives. Section 7 of the Instrument exempts derivatives advisers from many of the requirements of the Instrument when they are advising an EDP.

Are there any scenarios where derivatives advisers that are advising EDPs should be required to comply with any of the requirements that section 7 provides an exemption from?

We believe this exemption makes sense and is consistent with our prior comments. Registered advisers are already subject to a comprehensive registration and business conduct regime through NI 31-103, and derivatives registration and conduct regulation should, as much as possible, allow these firms to create synergies and leverage from the compliance personnel, systems, and policies relating to existing regulatory regimes. New requirements should only be imposed on registered advisers where a significant regulatory gap has been identified that is specific to derivatives, new conduct considerations, or new types of clients or counterparties.

Registrants would still benefit from specific, targeted guidance on exactly what additional procedures should be considered or implemented under the new OTC derivatives regime. As noted in our previous comment letter, while every registrant's business is different, efficiencies can be gained with an illustrative list of new policies or changes that should be considered for a variety of common illustrative scenarios. Registrant outreach and guidance in staff notices (particularly those responsive to staff findings in regulatory examinations after the introduction of regulation) to help meet these obligations will also be extremely important so that registrants can develop the necessary remedial compliance policies and systems proactively as necessary, rather than in response to findings of a costly compliance review and remediation process.

8) Conflicts of Interest

Section 9 of the Instrument was developed with the intention that it would be generally consistent with the conflicts of interest provisions of NI 31-103. The Client Focused Reforms amended the conflicts of interest provisions of NI 31-103 (through amendments to section 13.4 and the addition of section 13.4.1) and adopted related companion policy changes. We are considering further changes to conform the conflicts of interest requirements so that they are consistent with those in NI 31-103, along with other changes to conform the requirements to be consistent with the requirements found in Client Focused Reforms. Please provide any comments relating to the inclusion of such corresponding changes to the Proposed Instrument.

We agree that the provisions of NI 31-103 that were amended to implement the Client Focused Reforms should be considered in order to determine how they can best be adapted in the OTC derivatives context, though would urge that the top priority is that this Proposed Instrument is first implemented expeditiously, should the necessary changes in response to the CFRs be significant enough to either demand republication or substantive delays to the ultimate implementation of the Proposed Instrument. We were (and are) strongly supportive of many of the CFR initiatives that fundamentally shifted the advisor/client relationship, and believe it is important that these be considered in future but that the implementation of the Proposed Instrument not be held up as a result.

We note that many concepts found in the Client Focused Reforms are missing from the Proposed Instrument, and not only those that relate to conflicts of interest. As examples, there are misalignments in the Know-Your-Derivatives-Party provisions relative to the Know-Your-Client demands under the Client Focused Reforms, references to risk tolerance instead of risk profile, and the suitability expectations. These should be explained in differential terms in more detail in the companion policy. It could be helpful to include in the companion policy or in an appendix to the Proposed Instrument a chart indicating which specific Client Focused Reform concepts are not incorporated into the Proposed Instrument and do not yet apply to derivatives activities.

We understand that adding the concepts found in the Client Focused Reforms, including ensuring that the best interests of clients are in the forefront, is a nuanced issue when applied to the principal/non-agency nature of many transactions between dealers and their clients in the OTC derivatives market. Unlike advisers or dealers who may be in an agency relationship with a client, many OTC derivative transactions occur between sophisticated counterparties in a commercial relationship involving the extraction of value from the derivative through its structuring and features, for zero-sum gains and losses between counterparties. As a result, there are implicit conflicts in a typical OTC derivative transaction between counterparties that are not easily rectified through improved duties of care, and they do not necessarily all need to be fully mitigated for reasonable fair dealing expectations to be met given the circumstances of the relationship. The fair dealing requirements of the Proposed Instrument may be a good interim compromise until the salient issues in different types of transactional relationships can be more deeply considered alongside the enhanced duties introduced by the Client Focused Reforms.

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Concluding Remarks

We support many of the changes that have been made to the Proposed Instrument, particularly those that allow for burden reduction through leveraging existing compliance infrastructures. We look forward to the implementation of the Proposed Instrument as soon as practical.

We thank you for the opportunity to provide these comments and would be happy to address any questions you may have. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of*
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