ISDA Safe, Efficient Markets

SENT BY ELECTRONIC MAIL March 21, 2022

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

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Dear Sirs/Mesdames:

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*

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] has been actively engaged for many years with providing input on regulatory reforms impacting derivatives

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 970 member institutions from 77 countries. These members comprise a broad range of

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in major jurisdictions globally, including Canada. ISDA appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") in response to the 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. While ISDA acknowledges that the CSA will not be publishing Proposed National Instrument 93-102 *Derivatives: Registration* (the "**Proposed Registration Instrument**") and Proposed Companion Policy 93-102CP *Derivatives: Registration* (collectively, the "**Proposed Registration Rule**") concurrently with the Proposed Instrument at this time, this comment letter should be read together with ISDA's previous comment letter on the Proposed Registration Rule (the "**Proposed Registration Rule Comment Letter**") given the many overlapping issues in the two instruments.

1. General Observations

ISDA commented on the previous versions of the Proposed Business Conduct Rule in 2017[2] (the "**2017 Comment Letter**") and 2018[3] (the "**2018 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. In this letter we wish to reiterate and reinforce select material comments from the 2017 Comment Letter and the 2018 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

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derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube.

[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

[3] The ISDA comment letter on the 2018 version of 93-101 can be found online at https://www.osc.ca/sites/default/files/pdfs/irps/comments/com_20180917_93-101_darrask.pdf

Compliance Reporting Condition for Foreign Dealers

ISDA supports the proposed removal of the compliance reporting condition to the exemption for foreign advisers in Section 43 of the Proposed Instrument. However, ISDA and its members remain very concerned by the proposed condition to the exemption for foreign derivatives dealers in Section 38 of the Proposed Instrument. As proposed, derivatives dealers that rely upon this exemption will be required to report to Canadian securities regulators in a timely manner the following:

> *any circumstance in which the derivatives dealer is not or was not in compliance with the laws of the foreign jurisdiction relating to trading in derivatives to which the derivatives dealer is subject, if any of the following apply:*
>
> *(i) the non-compliance creates or created, in the opinion of a reasonable person, a risk of material harm to a derivatives party whose head office or principal place of business is located in Canada;*
>
> *(ii) the non-compliance creates or created, in the opinion of a reasonable person, a risk of material harm to capital markets in Canada;*
>
> *(iii) the non-compliance is part of a pattern of material non-compliance relating to the activities being conducted with one or more derivatives parties whose head office or principal place of business is in Canada.*

While ISDA supports limiting the conditions in paragraphs (i) and (iii) to material harm to, or activities conducted with, derivatives parties whose head office or principal place of business is in Canada, this reporting requirement would greatly exceed the regulatory reporting requirements that apply to most foreign dealers 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.

As noted previously, ISDA believes that the proposed exemption for foreign dealers should not include any regulatory reporting conditions, given that any dealer that relies on the exemption 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 exemption in the Proposed Instrument, the regulatory reporting must, at minimum, be consistent with a dealer's reporting obligations to its home jurisdiction regulator. ISDA therefore strongly encourages the CSA Derivatives Committee to re-consider the proposed compliance reporting condition for foreign dealers. If reporting is necessary, dealers 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 dealer's home jurisdiction. Accelerated reporting of global regulatory actions to securities

regulators Canada is not workable for large multinational dealers 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. Absent a reconsideration of the reporting conditions currently in Section 38 of the Proposed Instrument, there will be a risk that this requirement will deter non-Canadian dealers from participating in the Canadian markets, an outcome that ISDA and its members wish to avoid.

Eligibility for Substituted Compliance

ISDA appreciates that the CSA have published the proposed jurisdictions that are eligible for substituted compliance by foreign dealers and advisers and supports removing the list of analogous legal provisions across such jurisdictions. However, as previously noted, 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.

As previously noted, 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 their 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 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. As former CFTC Chairman Giancarlo noted:

> "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 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]."[4]

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. While ISDA supports the removal 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. We note that the list of substituted compliance jurisdictions included in the Proposed Instrument does not include all IOSCO jurisdictions.[5] 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. Requiring derivatives firms to apply for exemptive relief with respect to foreign IOSCO jurisdictions not listed in the appendices of the Proposed Instrument would impose undue costs on foreign derivatives firms who would otherwise benefit from substituted compliance with respect to such jurisdictions.

3. Other Business Conduct Exemptions

a. Harmonization of the exemptions provided in the Proposed Registration Rule and Proposed Business Conduct Rule

Unlike in the Proposed Registration Rule, there remains no *de minimis* exemption from the derivatives dealer business conduct requirements other than with respect to the senior derivatives manager regime. With respect, it is unclear why a firm may be entitled to rely on such a dealer registration exemption in the Proposed Registration Rule but not an exemption from the application of business conduct requirements. As previously noted, 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 notes that under the U.S. Commodity Exchange Act (the "**CEA**"), the CFTC was mandated to exempt from designation as a "swap dealer" (and, therefore, from the CFTC's registration and business conduct rules) entities that engage in a *de minimis* quantity of swap dealing in connection with transactions with or on behalf of its customers.[6] In adopting its rules regarding the determination of a swap dealer engaged in a *de minimis* quantity of swap dealing, the CFTC noted swap market efficiency, orderliness and transparency as a goal of swap dealer regulation and that the policy

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[4] Remarks by Chairman J. Christopher Giancarlo at the ISDA Industry and Regulators Forum, Singapore, September 12, 2018

[5] We note, for example, that the list excludes Argentina, the British Virgin Islands, the Cayman Islands, Chile, Mexico, India and Israel, among other foreign jurisdictions.

[6] CEA, §1a(49)(D).

objectives underlying the *de minimis* exception are designed to encourage participation and competition by allowing persons to engage in a *de minimis* amount of dealing without incurring the costs of registration and regulation. As well, the CFTC noted that an appropriate *de minimis* exception also increases regulatory efficiency by enabling regulatory resources to focus on entities whose swap dealing activity is sufficient in size and scope to warrant oversight. Such policy considerations are equally applicable to derivatives dealers under the Proposed Registration Rule and the Proposed Business Conduct Rule. Therefore, ISDA continues to recommend that a *de minimis* exemption identical to that in the Proposed Registration Rule be included in the Proposed Business Conduct Rule. However, ISDA recommends that the thresholds for both such *de minimis* exemptions mirror the thresholds applicable to the *de minimis* exemption under Section 31.1 of the Proposed Instrument from the senior derivatives manager obligations (i.e., with a $3,000,000,000 threshold for commodity dealers).

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.

While ISDA acknowledges that the CSA may see differences in policy reasons for granting an exemption from registration for crown corporations versus granting an exemption from business conduct requirements, 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

ISDA supports the proposed foreign liquidity provider exemption in Section 36 of the Proposed Instrument. ISDA continues to support a similar exemption in the Proposed Registration Rule and refers you to the Proposed Registration Rule Comment Letter with respect to its concerns with not providing such an exemption in the Proposed Registration Rule as well.

4. Definition of "eligible derivatives party"

ISDA appreciates that the CSA has removed the net asset threshold of $10 million from paragraph (n) of the definition of "eligible derivatives party" ("**EDP**"). In ISDA's view, this proposed change will ensure that mid-market entities are not excluded from access to OTC derivatives transactions and continue to result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSA's policy objectives.

However, ISDA remains concerned that the definition of EDP is cumbersome and mostly duplicates other established Canadian client definitions, such as "permitted client", but with slightly higher financial thresholds. As we observed 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 National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

As well, with respect to the EDP definition, members of ISDA again strongly encourage the CSA to consider that there is a need to align the EDP definition with the "eligible contract participant" ("**ECP**") definition under the CEA. 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. 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.

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.

Furthermore, with respect to paragraphs (m) 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. While ISDA acknowledges the CSA's concern that OTC derivatives are complex financial products, 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. 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.

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) or (o) of the EDP definition.

5. Other Issues

Definition of "affiliated entity"

We refer you back to our Proposed Registration Rule Comment Letter for further comments on the proposed definition of "affiliated entity". 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. Therefore, we appreciate that the CSA have avoided the potential for additional uncertainty by avoiding a material 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.

Further clarity regarding application of business conduct rules to derivatives firms

ISDA appreciates that the CSA have proposed additional changes in Section 23 in the Proposed Instrument to exempt a derivatives firm from the provisions of Division 2 [*Derivatives party assets*] of Part 4 [*Derivatives party accounts*] if the firm is subject to and complies with OSFI Guideline E-22 *Margin Requirements for Non-Centrally Cleared Derivatives* or a regulation that may be prescribed by the securities regulatory authority in respect of derivatives party assets.

However, ISDA recommends that the CSA provide additional guidance and clarity in the CP to clarify the application of the Proposed Instrument to derivatives dealers and advisers that operate in a globally integrated fashion. As ISDA noted in our Proposed Registration Rule Comment Letter with respect to the Proposed Registration Rule, we are similarly concerned that the Proposed Business Conduct Rule may give rise to significant unintended adverse business consequences for such derivatives dealers and advisers. For example, some global financial firms will involve individuals who represent multiple affiliated entities in a single derivatives transaction with a Canadian counterparty. One simple example of this approach is a global derivatives firm that maintains salespeople in a Canadian affiliate to solicit trades, trading personnel in a foreign affiliate to negotiate and price trades and execute confirmations, and a booking entity in a third jurisdiction that acts as the counterparty to trades. Another example of this approach is a global derivatives firm that provides advisory services through a Canadian affiliate that receives negotiation and trade execution support from a foreign affiliate.

For example, a Canadian registered adviser (A Co) may advise investment fund clients in Canada, but the negotiation and execution of derivatives transactions may be the responsibility of an affiliate (B Co) in a foreign jurisdiction under a trade services agreement between A Co and B Co. Under the Proposed Instrument, A Co is subject to the business conduct obligations in the Proposed Instrument as a derivatives adviser, and B Co may become subject to the business conduct obligations in the Proposed Instrument as a derivatives dealer due to its facilitation/intermediary activities unless it is able to avail itself of the exemption in Section 42 of the Proposed Instrument. However, it could be argued that from the perspective of the "group", services are simply being split up and it should be sufficient for A Co to comply with the business conduct obligations in the Proposed Instrument as a derivatives adviser, with the activity that is undertaken by the foreign affiliate being viewed as incidental to the advising activity. Correspondingly, where the services to a client are shared between affiliates, it should be sufficient if only one of the affiliates is required to comply with the business conduct obligations in the Proposed Instrument as either a derivatives adviser or a derivatives dealer, provided that the exempt affiliate's activities can be viewed as incidental to the non-exempt entity's activities.

ISDA submits that consideration should be given to either (i) clarifying the application of the Proposed Instrument to the scenario where activities are shared between Canadian and foreign affiliates in the CP or (ii) adding an additional exemption in the Proposed Instrument, to avoid unnecessary duplication of business conduct obligations across multiple affiliated entities. For example, it would be useful to provide guidance in the CP that a foreign derivatives counterparty to a trade that acts as a booking entity and is not involved in soliciting or negotiating the trade is not subject to the application of the Proposed Instrument where, in respect of the trade, its Canadian dealer affiliate complies with it. Another possibility would be the introduction of derivatives dealer and adviser exemptions from the Proposed Instrument that would be applicable where globally integrated firms involve multiple affiliated entities in a derivatives transaction, which exempts foreign affiliated entities that provide services to a Canadian affiliate, subject to the Canadian affiliated entity acting in compliance with its business conduct obligations under the Proposed Instrument. In addition, ISDA recommends that clarification be added to the CP that Section 4 of the Proposed Instrument may be interpreted as applying in some or all of the circumstances described above, if this is what is intended.

Self-reporting requirements

ISDA appreciates that the CSA have proposed to limit the self-reporting obligation pursuant to Section 32 of the Proposed Instrument to derivatives dealers. The requirement to self-report certain circumstances of material non-compliance to the CSA is not limited to foreign dealers, as discussed above. All dealers 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) Canadian financial institutions (pursuant to Section 40(b) of the Proposed Instrument). As previously noted, it is not clear to ISDA and its membership whether a new self-reporting requirement layer is necessary given that Canadian banks already have significant self-reporting requirements.

ISDA appreciates the CSA's response to comments received on the self-reporting obligation, in particular the CSA's response regarding paragraphs 5.2(c) and (d) of NI 31-

103 regarding other market participants under applicable provincial securities law. However, the proposed self-reporting requirement in Section 32 of the Proposed Instrument, which remains duplicative of the reporting requirements in Section 27(3)(d) of the Proposed Registration Instrument, differs from paragraphs 5.2(c) and (d) of NI 31-103 in that it would require more frequent reporting than that applicable to other market participants under NI 31-103. It is not clear to ISDA why such a significantly different standard in timing is justified. In the absence of any such justification, ISDA respectfully requests that the CSA re-consider the self-reporting requirement given that Section 31(3) of the Proposed Instrument imposes a reporting requirement on the senior derivatives manager of a derivatives dealer that is substantially equivalent to paragraphs 5.2(c) and (d) of NI 31-103.

Registration triggers for acting as a derivatives dealer or adviser

ISDA acknowledges the addition of the clarifications regarding the "business trigger" test in the CP regarding the exemptions under Part 6 [*Exemptions*] of the Proposed Instrument. 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 remain unwilling to limit the scope of derivatives dealing to 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 continue to 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

As previously noted, various requirements, such as suitability in Section 14 of the Proposed Instrument and referral arrangements in Section 15 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

ISDA acknowledges the CSA's response to our request to include, as an exemption from the suitability requirements under Section 14 of the Proposed Instrument, a safe harbour mirroring that of Regulation 23.434(b) 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) 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. In particular, ISDA appreciates that the CSA have proposed to eliminate the $10 million net assets threshold in paragraph (n) of the EDP definition and expand the class of derivatives parties in respect of whom a derivatives dealer may deal without being subject to a suitability obligation.

In ISDA's view, the Regulation 23.434(b) safe harbour is appropriate in cases of non-EDP derivatives parties given the stringent conditions for a derivatives firm to rely on the safe harbour. As well, including the requested safe harbour would further harmonize regulatory requirements with the U.S., thereby reducing compliance costs for derivatives firms. Alternatively, if the CSA do not wish to include the requested safe harbour, ISDA respectfully requests that the CP be further revised to clarify that the conditions of the safe harbour will be relevant factors in determining whether the suitability requirements under Section 14 of the Proposed Instrument have been satisfied.

Responsibilities of senior derivatives managers

ISDA appreciates that the CSA have proposed to limit the senior derivatives manager obligations pursuant to Section 31 of the Proposed Instrument to derivatives dealers and better reflect existing compliance structures at derivatives dealers. We also appreciate that the CSA propose to exempt derivatives dealers from Section 31 of the Proposed Instrument if, among certain other conditions, the dealer does not solicit or otherwise transact a derivative with a non-EDP.

However, ISDA continues to note that the proposed senior manager regime may risk deterring foreign dealers from fully participating in the Canadian market given that it is unique globally as a derivatives-specific regime, and adds unnecessary legal and

compliance burden to both foreign and domestic dealers. Given these burdens, if the CSA remains unwilling to remove the proposed senior manager regime altogether, ISDA alternatively recommends that the proposed notional amount limits on the exemption in Section 31.1 of the Proposed Instrument from the senior derivatives manager provisions for dealers dealing with EDPs be removed so that all such dealers may rely on the Section 31.1 exemption. Further, with respect to non-EDPs, ISDA continues to recommend that substituted compliance 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 appreciates that the CSA have limited Section 38(1)(e) (formerly proposed Section 38(3)(d)) and Section 43(1)(d) (formerly Section 43(3)(d)) of the Proposed Instrument to only those books and records of a foreign derivatives dealer or adviser relating to transactions with Canadian counterparties.

However, in connection with our comments above on Section 32 [*Responsibility of derivatives firm to report material non-compliance*] of the Proposed Instrument, ISDA also wishes to re-iterate its proposed wording change to Section 38(1)(e) 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:

> (e) 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 provides the regulator or, in Québec, the securities regulatory authority with prompt access to its books and records upon request with respect to any matter relating to the activities being conducted with a derivatives party whose head office or principal place of business is located in Canada.

We note that the same wording change should apply to Section 43(1)(d) of the Proposed Instrument and any other sections of the proposed rule that require that materials be provided to a securities regulatory authority.

Anonymous transactions executed on a derivatives trading facility

ISDA appreciates that the CSA have proposed to broaden the exemption in Section 41 of the Proposed Instrument to exempt dealers from all requirements in the Proposed Business Conduct Rule, except fair dealing, complaints handling and Part 5 [*Compliance and recordkeeping*] requirements when the transaction is executed and subject to the rules of a derivatives trading facility and the derivatives dealer does not know the identity of its counterparty at the time the transaction is executed regardless of whether or not the transaction is ultimately cleared. However, as previously noted, ISDA recommends that the CSA broaden the exemption to include a standalone exemption for transactions that are not traded on a derivatives trading facility but that are submitted for clearing to a regulated clearing agency.

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 or submitted for clearing to a regulated clearing agency, rather than limiting the exemption to these specific 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 contrary to the principles underlying Canada's G20 commitments.

Handling complaints

ISDA notes that the CSA propose to expand the handling complaints obligations in Section 11 (formerly Section 16) of the Proposed Instrument to all derivatives parties, including EDPs. As previously noted, such obligations 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 further unnecessary administrative and compliance burdens.

Derivatives party assets

ISDA acknowledges that the CSA have retained the requirements with respect to initial margin in Sections 25 and 26 of the Proposed Instrument (which only apply to transactions with non-EDPs). As previously noted, 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*.

Procedures, policies and controls

ISDA acknowledges that the CSA have retained Section 30(1)(c)(iii) of the Proposed Instrument which 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. ISDA appreciates that the CSA have clarified in the CP that a firm-wide code of conduct/ethics policies can be relied on as part of satisfying this obligation and that the CSA expect each employee to provide some form of an acknowledgement (typically updated annually) to the derivatives firm that they are complying with such code of conduct.

As previously noted, 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 continued 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. Alternatively, ISDA recommends that the actions set forth in the clarifications to the CP instead be included as a safe harbour with respect to the Section 30(1)(c)(iii) obligation in the Proposed Instrument.

6. Effective date and scope of Proposed Business Conduct Rule

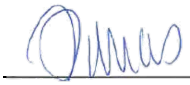
ISDA appreciates that the CSA have included proposed transition periods to allow derivatives firms to treat existing permitted clients, qualified parties, accredited counterparties and ECPs as EDPs for up to five years and to exclude transactions entered into before the effective date of the Proposed Instruments with such derivatives parties. However, since derivatives firms will transact with derivatives parties that do not fall within such transition rules, we continue to recommend that 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 representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation. Accordingly, we continue to 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, subject to the proposed transition rules.

* * * *

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

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) Foreign Liquidity Provider Exemption

We have introduced a new foreign liquidity provider exemption in section 36 of the Instrument for foreign dealers that transact with derivatives dealers located in Canada. This is an outright exemption from the requirements in the Proposed Instrument intended to preserve market access and maintain general liquidity in the inter-dealer market. As a result, a Canadian derivatives dealer, regardless of its size, will benefit from this provision. This also means that the core provisions in the Instrument will not apply when a local derivatives dealer is transacting with a foreign derivatives dealer.

Do you support including this additional exemption in section 36 of the Proposed Instrument?

Yes, ISDA supports including this additional exemption. As noted above, ISDA continues to support a similar exemption in the Proposed Registration Rule and refers you to the Proposed Registration Rule Comment Letter with respect to its concerns with not providing such an exemption in the Proposed Registration Rule as well.

2) Foreign Derivatives Dealer and Foreign Derivatives Adviser Exemptions—Comparability Determinations

A foreign dealer or adviser from a foreign jurisdiction that, on an outcomes-basis, has comparable requirements to those in the Instrument will receive a complete exemption from the Instrument where that foreign dealer or adviser complies with the conditions of the exemption in section 38 or the exemption in section 43. Outcomes-based assessments have been conducted for the jurisdictions listed in Appendices A and D. Please provide any comments you may have on the inclusion of any of the foreign jurisdictions listed in these Appendices.

Should any other foreign jurisdiction(s) with comparable requirements be added to these Appendices? Please explain your response with reference to the applicable legislation and related requirements.

ISDA appreciates that the CSA have published the proposed jurisdictions that are eligible for substituted compliance by foreign dealers and advisers in Appendices A and D of the Proposed Instrument. As noted above, ISDA supports a comprehensive approach whereby any jurisdiction that is a member of IOSCO would be an appropriate substituted compliance regime. We note that the lists of specified foreign jurisdictions included in Appendices A and D (and, with respect to foreign sub-advisers, Appendix E) do not include all IOSCO jurisdictions. From a policy perspective, ISDA's view is that there is no justification to limiting these lists to countries that are

located in only certain IOSCO jurisdictions. Requiring derivatives firms to apply for exemptive relief with respect to foreign IOSCO jurisdictions not listed in Appendices A, D and E would impose undue costs on foreign derivatives firms who would otherwise benefit from substituted compliance with respect to such jurisdictions.

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?

Yes, ISDA supports limiting the reports to the regulator contemplated by Section 38(1)(d) of the Proposed Instrument to only cover a foreign derivatives dealer's activities with a derivatives party that is located in Canada. However, please refer to our comments above in paragraph 2 with respect to our other concerns regarding Section 38(1)(d).

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?

Yes, ISDA supports eliminating the $10 million financial threshold for qualifying as a commercial hedger and believes that this new approach will have a positive effect on the ability of non-EDP clients to access liquidity from dealers and on a dealer's willingness to trade with non-EDP clients. As noted above, in ISDA's view, this proposed change will ensure that mid-market entities are not excluded from access to OTC derivatives transactions and continue to result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSA's policy objectives.

However, please refer to our comments above in paragraph 4 with respect to our other concerns regarding the "eligible derivatives party" definition.

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?

ISDA refers the CSA to its comments in paragraph 5 above regarding the senior derivatives manager provisions in the Proposed Instrument. As noted above, ISDA continues to note that the proposed senior manager regime may risk deterring foreign dealers from fully participating in the Canadian market given that it is unique globally as a derivatives-specific regime, and adds unnecessary legal and compliance burden to both foreign and domestic dealers. Accordingly, if the CSA remains unwilling to remove the proposed senior manager regime, ISDA recommends that the proposed notional amount limits on the exemption be removed. Further, with respect to non-EDPs, ISDA continues to recommend that substituted compliance 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.

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?

ISDA supports the CSA's approach to only apply the specified provisions to Canadian financial institutions that are derivatives dealers with respect to its short-term FX transactions in the institutional FX market as this will support the Canadian FX spot market. However, in ISDA's view the *de minimis* threshold of $500 billion should be increased to ensure continued support for the Canadian FX spot market as it grows in size.

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?

ISDA agrees with the approach to add an exemption in Section 45 of the Proposed Instrument for registered advisers under securities or commodity futures legislation from certain requirements of the Proposed Instrument listed in Appendix F if the registered adviser complies with the corresponding requirements in NI 31-103 relating to a transaction with a derivatives party. In ISDA's view, such corresponding requirements in NI 31-103 provide substantially equivalent protections to derivatives parties.

ISDA does not believe there are any scenarios where derivatives advisers that are advising EDPs should be required to comply with any of the requirements that Section 7 of the Proposed Instrument provides an exemption from.

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.

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?

ISDA acknowledges that the CSA are considering (i) further changes to conform the conflicts of interest requirements so that they are consistent with those in NI 31-103 and (ii) other changes to conform the requirements to be consisted with the requirements found in the Client Focused

Reforms. However, in ISDA's view, no such changes are necessary or appropriate at this time as such changes will increase compliance costs for derivatives dealers and advisers. Given that derivatives dealers and advisers will already be required to undertake substantial operational changes to comply with the existing proposed provisions of the Proposed Business Conduct Rule, such further compliance costs would be an undue burden on derivatives dealers and advisers. Rather, ISDA encourages the CSA to consider any such conforming changes at a later date after derivatives firms have had sufficient time to implement changes necessitated by the Proposed Business Conduct Rule.