FIRMA Foreign Exchange

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February 5, 2013

Mr. John Stevenson, Secretary
Ontario Securities Commission
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Ms. Anne-Marie Beaudoin
Corporate Secretary
Autorité des marches, 22e étage
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Dear Mr. John Stevenson and Ms. Anne-Marie Beaudoin:

In response to the Canadian Securities Administrators ("**CSA**") OTC Derivatives Committee ("**Committee**") request for comment issued with CSA Staff Consultation Paper 91-301 ("**CSCP 91-301**"), FIRMA Foreign Exchange Corporation ("**FIRMA**") wishes to provide the CSA with commentary on:

- Model Provincial Rule - *Derivatives: Product Determination* (the "**Scope Rule**");
- Model Explanatory Guidance to Model Provincial Rule - *Derivatives: Product Determination* (the "**Scope EG**");
- Model Provincial Rule - *Trade Repositories and Derivatives Data Reporting* (the "**TR Rule**"); and
- Model Explanatory Guidance to Model Provincial Rule - *Trade Repositories and Derivatives Data Reporting* (the "**TR Rule**");

(collectively the "**Commentary Items**").

We are appreciative of the opportunity to provide our feedback to the Committee on the Commentary Items in advance of their final publication, and recognize that the Commentary Items have been drafted based on the Ontario securities laws, so other jurisdiction's regulators (including the regulator in Alberta, FIRMA's home jurisdiction) may be publishing slightly varied rules, explanatory guides and appendices.

ABOUT FIRMA

As an industry participant, we believe that a brief explanation of FIRMA's business model is important for the purpose of providing context to our responses on the Commentary Items. FIRMA is an international leader in corporate foreign exchange as well as large-scale personal foreign currency exchange transactions. FIRMA targets a niche customer base that is underserved by banks by providing more favorable exchange rates, lower transaction costs, and a differentiated level of personalized service.

FIRMA has grown significantly since its inception in 1998. Beginning with three employees and increasing into the multi-national firm it is today, employing over 220 people world-wide. FIRMA's growth has been largely attributed to organic growth via the addition of new offices and expansion into multiple geographies. Today, FIRMA operates across nineteen branch locations in Canada, along with three branches in the United Kingdom, the United States, Australia, and New Zealand. FIRMA has a strong financial track record, reporting profitable and significant growth since its inception in 1998.

FIRMA provides foreign exchange solutions for retail and wholesale customers. The services we provide are founded on a principle of providing cost-effective foreign exchange services to companies that require foreign exchange financial certainty in their business operations. We do not view our services as trades in the traditional securities or derivatives markets because, unlike speculators in these markets, our clients are not looking to capitalize on the fluctuating nature of foreign currency, but rather to remove this variability from being a factor in their pricing models.

The three ways in which our clients typically utilize FIRMA to achieve these objectives are through (i) Spot Orders, (ii) Market Orders and (iii) Forward Contracts.

(i) Spot Orders are foreign exchange contracts that allow FIRMA clients to instruct us to acquire a fixed amount of foreign currency at any given time for immediate settlement. On a self-directed basis, the client will determine when the exchange rate for a foreign currency has reached a conversion cost that fits their pricing model and they will then execute an immediate transaction on this basis.

(ii) Market Orders are essentially conditional, deferred Spot Orders. Clients that have pre-calculated foreign exchange conversion rates built into their pricing models can instruct FIRMA to acquire foreign currency as soon as the exchange rate for the foreign currency falls within their customized cost parameters. After execution of the Market Order, FIRMA monitors the exchange rates and executes a transaction once the rate matches the client's instructions.

(iii) Forward Contracts are specialized orders where FIRMA will provide foreign exchange contracts to clients based on present foreign currency exchange conditions for settlement at a future date (no greater than 12 months from the date of order). This service allows FIRMA clients to plan long-term pricing certainty without having to amass and hold unnecessary foreign exchange cash surpluses in advance of needing that foreign currency. On the future settlement date, the transaction is settled and the client purchases the pre-determined amount of foreign currency at the pre-determined price. Forward Contracts may be subject to a deposit requirement as deemed necessary from time to time. The client will be notified of any deposit requirement in advance of entering into any forward contract with us.

All three of these services are non-speculative in nature, and are used by our clients to conduct their own business operations; not to create investment opportunities. Our clients use our Spot Orders and Market Orders because of the service benefits they receive:

- Simple, convenient and competitive foreign currency pricing;
- Industry-leading customer service; and
- Business relationships with a FIRMA sales person that understands their business needs.

In addition to these benefits, FIRMA's clients also use our Forward Contract service to ensure price certainty over fixed intervals of up to 12-months, to allow them to focus on their own business operations rather than the potentially volatile markets. FIRMA's clients are typically small to medium sized enterprises in industries that are required to buy or sell foreign currencies in order to buy or sell products or services in foreign jurisdictions. They fit within any number of industries but all share the common business reality of having to acquire foreign currency in order to facilitate cross-border transactions.

CURRENT SECURITIES REGULATORY REGIME

In Alberta, it is our current understanding that Spot Orders and Market Orders are not treated as "OTC Derivatives" under securities legislation and the Forward Contracts are subject to Blanket Order 91-505 ("**BO 91-505**"), which exempts FIRMA from the requirement to register as a securities Dealer (as defined in the Alberta *Securities Act*) and trade subject to a prospectus (or applicable prospectus exemption found in National Instrument 45-106).

Under BO 91-505, the FIRMA Forward Contract transactions are exempted on the basis that both FIRMA and the client are "qualified parties"; persons or companies that sell, buy, trade, produce, market, broker or otherwise use the foreign exchange commodity in their business and enter into over-the counter trades in futures contracts only as a consequence of this business activity.

FIRMA believes that this exemption is appropriate for the foreign exchange services it provides because the trading activity is a business reality of commercially using foreign currency and is not speculative. In fact (and contrary to the traditional nature of a speculative derivative), FIRMA Forward Contracts are being used to limit the client's exposure to the activities of speculative traders and the currency fluctuations that they create.

Based on CSCP 91-301, we were unable to determine whether or not BO 91-505 would remain in force upon publication of the rules proposed in the Commentary Items. FIRMA believes that the qualified party exemption created by transactions among commercial users does not carry a risk of harm to the public, and allowing BO 91-505 to continue in force would not be contrary to the Committee's objectives in meeting its G-20 commitments.

Even if BO 91-505 were to remain in force, the Commentary Items propose new requirements which do not appear to be exempted for "commercial users" and would negatively impact the market segment relying on Forward Contracts for cost-certainty rather than speculative purposes.

IMPACT OF THE SCOPE RULE

The Scope Rule makes it clear that FIRMA Spot Orders for the purchase and sale of currency are a form of excluded derivative because they require (among other things) the counterparties to make or take physical delivery of the currency within 2 business days. We believe that this exclusion will also apply to FIRMA Market Orders because the condition precedent to the agreement is that a pre-determined currency exchange rate occurs, and the delivery of the physical currency is made within 2 business days of the Market Order being perfected by the condition precedent.

NOTE: We recognize that the Scope Rule exclusion is less clear with respect to Market Orders than with respect to Spot Orders. To this effect, we think it would be beneficial for the Committee to provide clarification on whether or not a "spot market contract" can be executed in excess of 2 business days prior to physical delivery_so long as that "spot market contract" is only effective upon the happening of a particular event and physical delivery occurs within 2 business days of that event.

Unlike Spot Orders and Market Orders, the FIRMA Forward Contracts do not fit within the Scope Rule's derivative exclusions and would appear to be subject to the requirements of the TR Rule. There has been some discussion of an End-User Exemption in CSA Consultation Paper 91-405 and in paragraph 1(3) of the Scope EG, however, as I understood, comments made during the Derivatives Roundtable discussion held on January 16, 2013 (the "**Roundtable Discussion**") indicated that the TR Rule would apply to any derivative not otherwise excluded under the Scope Rule, including derivatives purchased by end-users.

Note: Although the Scope EG states at paragraph 1(3) that the Scope Rule only applies to the TR Rule, the Committee also acknowledges that elements of the Scope Rule (subject to necessary amendments) will be made applicable to certain provisions of other securities legislation. Depending on the content of forthcoming CSA Staff Consultation Papers regarding end-user exemptions, trading platforms, capital and collateral requirements, and derivatives trading registration (some of which, I understand, were discussed during the Derivatives Roundtable), FIRMA is concerned that the full impact of the Scope Rule may not yet be calculable. For this reason, we wish to enquire whether or not the Committee will be reviewing the Scope Rule on a continuous basis and allowing industry to comment on its application towards future CSA Staff Consultation Papers; particularly with respect to end-user or commercial user exemptions.

Since FIRMA's Spot Orders, Market Orders and Forward Contracts are all targeted towards the same client profile of "commercial end-user", we believe that materially distinguishing how these services are treated under securities legislation will create confusion for public consumers. From the client's perspective, Spot Orders and Forward Contracts are being purchased for the same business purpose however the Scope Rule requires that they be treated differently. FIRMA's clients will need to be provided with significant clarification and disclosure on the differences between the types of services: the logistics of closing, the amount of information that is required to participate in a service, and the proportionate cost of each service that is being applied to compliance, legal and reporting obligations rather than to the acquisition of foreign currency to be provided to the client.

FIRMA believes that this has the potential to cause confusion because Forward Contracts are (in our opinion) not traditionally among the class of derivative that the Committee is seeking to regulate through implementation of the new regulations.

In contrast to traditional derivatives, foreign exchange Forward Contracts always require both parties to physically exchange the full amount of currency on fixed terms that are set at the outset of the contract. Market participants know the full extent of their own payment obligations to the other party to a trade throughout the life of the Forward Contract. We do not offer non-deliverable contracts and only deal with the physical exchange of currency.

Because Forward Contract transactions involve the actual exchange of currency, settlement risk (the risk that one party to the foreign exchange transaction will pay the currency it sold but not receive the currency it bought), is the main source of risk in these transactions. There is extensive documented process and restriction in FIRMA's payment systems that permit the transfer of one currency to take place only if the final transfer of the other currency also takes place and has physical (electronic) delivery of currency to FIRMA. So long as the transaction is being fully executed on the settlement date (which can be ensured, in part because both the client and FIRMA are the only party to the Forward Contract), we believe that this risk is significantly mitigated.

Further, FIRMA Forward Contracts are predominantly short-term transactions (30% percent of our Forward Contracts mature in less than 30 days; 80 percent of our Forward Contracts mature in less than 90 days; the maximum maturity period is 365 days). Traditional derivatives have much longer average maturity terms, ranging from two to 30 years. Although the time-frame between execution of a Forward Contract and physical delivery of the foreign currency is in excess of the 2 business days prescribed by the Scope Rule, it is still different than the long-term derivatives which are re-traded speculatively and bundled into packaged securities. Because of their relatively short duration, FIRMA believes that non-speculative Forward Contracts pose less counterparty credit risk than traditional derivatives.

For this reason, we believe that the "two business day" restriction found in the Scope Rule at section 2(c) should be expanded if the purchaser is a commercial end-user.

NOTE: We note that the Scope Rule is based on the Securities Act (Ontario) which has a definition for "derivative" while the Securities Act (Alberta) does not. Does the Committee anticipate having a definition of "derivative" inserted into the Securities Act (Alberta), and will securities pursuant to section (1)(ggg)(xvi) - "any item or thing that is a futures contract or an option" - of the Securities Act (Alberta) be considered both a derivative and a security? This could create some regulatory duplication. We understand that similar considerations would be necessary for all regulatory jurisdictions in Canada.

IMPACT OF THE TR RULE

As discussed under our comments on the "Impact of the Scope Rule", the Commentary Items suggest that FIRMA's Forward Contracts will be treated significantly different than Spot Orders and Market Orders from a regulatory perspective. In addition to potential client confusion, there will be a high administrative and compliance cost to transacting in Forward Contracts which will be borne by non-speculative foreign exchange clients.

The external costs associated with reporting trade transactions to an approved trade repository cannot be calculated, but we anticipate these costs being in excess of $500,000 per year. Further, this is based on the assumption that a third party trade repository would be established that will accept the form of Forward Contract being used by FIRMA and other non-speculative foreign exchange providers. In the event that a specialized Trade Repository would need to be created, the costs could be significantly higher.

Internal costs would also rise significantly with Forward Contract trade repository reporting. Given the market conditions for competent IT staff in addition to management and executive's time required to facilitate and supervise real-time reporting, we estimate that this could cost in excess of $500,000 during the initial stages of implementation. As a small-medium sized enterprise, the cost would materially impact FIRMA's ability to compete with larger financial institutions providing similar services, and would undermine our ability to provide a cost-competitive product to our clients.

Noting that protecting our clients is of paramount importance; cost is still a significant consideration for FIRMA and causes us the greatest amount of concern with respect to the impact the Commentary Items could have on the non-speculative foreign exchange business if enacted. The reason why our clients enter into foreign exchange Forward Contracts as commercial users is that they are able to establish foreign exchange cost-certainty without having to monitor continuously fluctuating markets. This ultimately allows them to redirect their internal resources to their individual areas of expertise and better compete on an international level.

As compliance costs increase, they are invariably passed on to the consumer. We believe that the cost of protecting public consumers of derivatives in specialized industries such as non-speculative foreign exchange should not outweigh the benefits derived from those protections. In the case of foreign exchange contracts entered into by commercial end users, we do not believe that the Commentary Items achieve this goal. Foreign exchange Forward Contracts for non-speculative purposes do not carry the same degree of risk as traditionally traded derivatives and the disproportionate cost of complying with proposed regulatory restrictions would be passed on to end-users. If the additional cost of acquiring Forward Contracts began to outweigh the benefits derived by the end-users, these businesses would then cease to take advantage of this price-certainty model, and there could be a chilling effect on the competitiveness of Canadian small and medium enterprises in foreign markets.

Regulating non-speculative trading such as commercial end-user investment in foreign exchange Forward Contracts may also create the unintended side-effect of increased participation in speculative investing by entities that would not otherwise be partaking in this riskier activity.

The qualified party exemption created by transactions among commercial users in BO 91-505 does not apply to investors who are acquiring commodities for speculative purposes and possible re-trade gains. Presumably, this makes non-speculative trading more accessible than speculative trading. If the cost of acquiring non-speculative derivatives becomes comparable to acquiring speculative derivatives (or worse, more expensive), market participants may be incented to take on the riskier speculative activity due to perceived higher gains. FIRMA believes that this would undermine the Committee's original intention of resolution.

CONCLUSION AND PROPOSALS

At FIRMA, we believe that the unique nature of non-speculative Forward Contracts in the foreign currency market by commercial end-users is a unique subset of the derivatives market that should be excluded from the current breadth of regulation because they do not carry the same risk profile. By increasing the compliance costs of small to medium sized enterprises participating in Forward Contract currency activities as a means of achieving cost certainty for their business operations, not only could cross-border competitiveness of Canadian companies be negatively impacted, but these businesses might actually be incentivized to increase their participation in high-risk speculative derivative trading in an effort to hedge against the increased costs.

A commercial end-user exemption similar to that found in BO 91-505 would sufficiently exempt these non-speculative activities under the TR Rule however market protection could be further bolstered by having prohibitions on re-trade to prevent the Forward Contracts from becoming anything other than bilateral business transactions and by implementing cash hold periods to protect against settlement risk.

Nonetheless, in the event that the Commentary Documents are enacted in their current (or a substantively similar) form, we would ask that the Committee consider granting non-traditional derivative participants an increased transition period so that the impact cost to clients can be decreased as much as possible.

Regards,

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