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TO Ontario Securities Commission  
FROM Priscilla Bunke, Associate  
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SUBJECT Proposed Exemption for the Canadian Derivatives End-User published by Canadian Securities Administrators

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### Summary

On April 13, 2012, the Canadian Securities Administrators ("CSA"), the voluntary umbrella organization of Canada's provincial and territorial securities regulators through its Derivatives Committee ("Committee"), published for public comment a further Consultation Paper *91-405 Derivative: End-User Exemption*<sup>1</sup> ("CSA Paper 91-405") as part of the CSA's commitment to establish a comprehensive framework for OTC derivatives regulation and balance the need to meet international commitments with the needs of individual market participants in Canada. In broad terms, the intent of the proposed End-User exemption contained in CSA paper 91-405 described by Bill Rice, Chair of the CSA and Chair and CEO of the Alberta Securities Commission, "would permit a business that uses OTC derivatives to manage its own business risks to continue to use these products in a cost effective manner, without increasing risk to the overall market".

The CSA states that the purpose of CSA Paper 91-405 is to set out the Committee's position with respect to the End-User exemption. It stayed true to the pattern in its previously-published consultation papers within the context of the proposed Canadian derivatives regulatory regime, to highlight its analysis of what it has considered in making its recommendations for a proposed requirement of regulating derivatives; then laying out some recommendations on how it proposes to do so, and concluding by posing specific questions to the public asking if its recommendations are appropriate and if other issues or alternatives should be considered.<sup>2</sup>

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<sup>1</sup> [http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-405/4169440-v1-CSA\\_Consultation\\_Paper\\_91-405\\_Derivatives\\_\\_End-User\\_Exemption.pdf](http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-405/4169440-v1-CSA_Consultation_Paper_91-405_Derivatives__End-User_Exemption.pdf)

<sup>2</sup> [http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-401/3672026-v1-CSA\\_Consultation\\_Paper\\_91-401.pdf](http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-401/3672026-v1-CSA_Consultation_Paper_91-401.pdf);  
[http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/Canadian%20Securities%20Administrators%20Consultation%20Paper%2091-402%20Derivatives%20-%20Trade%20Repositories/3902179-v1-Canadian\\_Securities\\_Administrators\\_Consultation\\_Paper\\_91-402\\_on\\_Derivatives\\_\\_Trade\\_Repositories\\_.pdf](http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/Canadian%20Securities%20Administrators%20Consultation%20Paper%2091-402%20Derivatives%20-%20Trade%20Repositories/3902179-v1-Canadian_Securities_Administrators_Consultation_Paper_91-402_on_Derivatives__Trade_Repositories_.pdf);  
[http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-403/4042315-v1-CSA\\_Consultation\\_Paper\\_91-403\\_Derivatives\\_\\_Surveillance\\_and\\_Enforcement.pdf](http://www.albertasecurities.com/securitiesLaw/Regulatory%20Instruments/9/91-403/4042315-v1-CSA_Consultation_Paper_91-403_Derivatives__Surveillance_and_Enforcement.pdf)

CSA Paper 91-405 among other things discusses the following:

- the regulatory objectives considered by the CSA Derivatives Committee in relation to End-User exemption status;
- the scope of the exemption available for eligible End-Users. It **does not exempt** from the requirement to report trades to a trade repository;
- the criteria that will be considered for eligibility under the End-User exemption;
- the criteria that will not be considered for eligibility for the End-User exemption;
- what will an End-User have to do to rely on the exemption, and
- the process for obtaining the End-User exemption.

CSA Paper 91-405 does **not** do the following:

- define criteria to qualify to use the End-User exemption;
- propose sector-specific exemptions, and
- require eligible End-Users to undertake their trading activities under standardized contract terms.

### **Regulatory Objectives**

The End-User Exemption is intended to be available to market participants who are not required to be registered under securities laws because they are not in the business of trading derivatives i.e. they trade for their own account to hedge their commercial risk and they are not systemically important to the market.

The Committee does not provide any criteria for determining who is in the business of trading derivatives for their own account and who is not systemically important to the market, thereby placing the onus on market participants to determine if they are eligible End-Users and will qualify for the End-User Exemption. This onus placed on market participants is a common theme throughout the CSA Paper 91-405.

**Scope of the End-User Exemption**

The End-User exemption is intended for "*eligible market participants*" that use OTC derivatives trading activity to manage and mitigate risks related to the operation of their business. The term "*eligible market participants*" is not defined in the CSA Consultation Paper, thereby making it the End-User's prerogative to decide to rely on the exemption.

The End-User exemption will exempt many eligible End-Users from many of the new CSA proposed regulatory requirements applicable to market participants such as the requirement to clear OTC derivatives or registration, but it **will not** exempt End-Users from the requirement to report trading activity to a trade repository.

**Criteria that will be considered for eligibility under the End-User exemption**

The Committee rejected the idea of defining criteria to qualify to use the End-User exemption, but recommends that criteria be developed related to qualifications necessary for End-Users to rely on the exemption.

The Committee, based on information about the Canadian market and information from the United States and Europe holds the present views on appropriate eligibility criteria for the End-User exemption:

- i. Trading for own account, not a registrant or affiliate of a registrant;
- ii. Not a financial institution;
- iii. Hedging to mitigate commercial risks related to the operation of a market participant's business
- iv. Centralized risk management and intra-group trading considerations, and
- v. Large Derivatives participants considerations

**Criteria that will not be considered for eligibility under the End-User exemption**

The Committee considered, but excluded from further consideration the following eligibility criteria:

- vi. Exemption based on volume or notional dollar values of trades;
- vii. Sector specific exemptions, and
- viii. Standardized contracts and clearing.

**What will an End-User have to do to rely on the exemption?**

The Committee examined three general regulatory approaches that it could use in order for a market participant to commence relying on the proposed End-User exemption, and it concluded that the third option, which is providing notice to the regulator of an intention to rely on the exemption, is the most appropriate and efficient method of administering the proposed End-User exemption.

**The Process for obtaining the End-User exemption**

The Committee recommended the following process to be followed by eligible End-Users to rely on the exemption:

1. *Board of Directors' approval to demonstrate hedging compliance:*

An entity proposing to rely on the End-User exemption will be required to obtain the approval of the board of directors (or equivalent) to demonstrate hedging compliance before relying on the exemption to trade in OTC derivatives contracts;

2. *Notice to regulator of intention to rely on End-User exemption:*

The Committee states that the notice would be a one-time filing of basic information about the market participant. Once filed it further states, it would not need to be changed unless there was a material change in the information

3. *Record-keeping*

**Notes**

For more information on the CSA Paper 91-405, the comparison of this proposed CSA End-User exemption with the proposed US Exception to the mandatory clearing of swaps under the US Dodd-Frank Act and the rest of the CSA proposed derivatives regulatory regime, please contact the author:

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**Word of Caution**

This commentary provides only an outline and does not constitute legal advice. Specific legal advice should be obtained before making any decisions regarding the CSA proposed End-User exemption.