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DELIVERED VIA ELECTRONIC MAIL

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Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
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Dear Sirs/Mesdames:

Re: Comment Letter to CSA Staff Consultation Paper 91-407 - Derivatives Registration

Dentons Canada LLP on behalf of the Canadian Energy Derivatives Working Group (the "**Working Group**"), hereby submits these comments in response to the *CSA Staff Consultation Paper 91-407 Derivatives: Registration* (the "**Derivatives Registration Paper 91-407**") drafted by the Canadian Securities Administrators' (the "**CSA**") Derivatives Committee (the "**Committee**"). The Working Group appreciates the opportunity to engage the CSA as it seeks to support Canada meeting its G-20 commitments and establishing a regulatory framework for the over-the-counter ("**OTC**") derivatives market in Canada. The Working Group foresees an ongoing dialogue with the CSA in connection with these initiatives.

I. INTRODUCTION

The Working Group is a diverse group of Canadian energy market participants whose primary business activities include the building of energy infrastructure, the exploration, development, production and physical delivery of one or more energy commodities (crude oil, natural gas, electricity, emissions offsets, etc.) to other energy market participants and commodity end-users including industrial, commercial and residential consumers.

Members of the Working Group comprise Canadian, U.S. and other international corporate families that primarily use both exchange traded and over-the-counter ("OTC") derivatives (forward contracts, futures contracts, and swaps and options, as understood in the industry), and other contracts that reference energy commodities, to hedge commercial risks that arise in the conduct of their businesses, and for the purposes of optimizing assets, including through commodity price discovery and market intelligence.

The Working Group has formed to consider the Canadian regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities, and to respond to requests for public comment regarding such aforementioned Canadian regulatory and legislative developments.

II. GENERAL COMMENTS

The Working Group believes that its members are commercial hedging end-users and traders of derivatives (both exchange traded and OTC) primarily for the purposes of hedging commercial risks and asset optimization. These hedging activities foster the development and continued operations of energy infrastructure, the production of energy, the marketing of Canadian natural resources to domestic and international markets and the insulation of customers from price volatility in energy markets. Although the Working Group also believes that its members are likely not "derivatives dealers", "derivatives advisers" or "large derivatives participants", as defined in Derivatives Registration Paper 91-407, the Working Group is offering the following comments in the event that the CSA finalizes the proposals contained in Derivatives Registration Paper 91-407 (the "**Proposals**"), into model provincial rules in which those terms are construed too broadly, so as to apply to members of the Working Group. The Working Group respectfully submits that such a broad construction of the Proposals would have a materially adverse impact on Canadian energy commodity trading and Canadian energy derivatives markets.

The Working Group has other general comments regarding the CSA rule-making process as follows:

The CSA Rule-Making Process- Evaluation of Comments and Implementation of the Eventual Model Provincial Rules

In all the published CSA Staff consultation papers to regulate the OTC derivatives market in Canada, including Derivatives Registration Paper 91-407, the Committee has sought comments and input from stakeholders on its proposals but has never explained how it evaluates and treats such comments. As stated by the Canadian OTC Derivatives Working Group¹ in its Discussion Paper: *Reform of Over-the-Counter (OTC) Derivatives Markets in Canada* (the "**Discussion Paper**"), "the fulfillment of the G-20 commitments is a public-sector initiative that will require significant engagement of the industry". The Working Group respectfully asks that the Committee bears in mind that Working Group members and

¹ An interagency group chaired by the Bank of Canada, composed of members from the Office of the Superintendent of Financial Institutions (OSFI), the federal Department of Finance, the Ontario Securities Commission, the Autorité des marchés financiers, the Alberta Securities Commission and the Bank of Canada. The Bank of Canada, OSFI and the federal Department of Finance represent Canada on the Financial Stability Board and are responsible for Canada meeting its G20 commitments

other interested stakeholders are new to the CSA process. Accordingly, an explanation about the CSA rule-making process would significantly help market participants engage in and understand the process and anticipate future regulatory developments.

Most members of the Working Group, because of their cross-border, or intra-U.S., OTC derivatives trading activities are already subject to some of the requirements of the United States (“U.S.”) Dodd–Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”). As such, most Working Group members are familiar with the public participation process in the U.S., under the U.S. *Administrative Procedure Act*, that guides the rulemaking procedures by U.S. regulators and advances rulemaking quality and legitimacy by promoting transparency² and public participation³. The Working Group respectfully recommends that the CSA look at emulating the tenets of the US rulemaking procedures of transparency and public participation and seek to promote quality decisions by helping generate rules that advance the efficiency of the Canadian capital markets, provide investor protection, reduce systemic risk and comport with the respective CSA members’ statutory mandates.

In CSA Consultation Paper 91-301 – *Model Provincial Rules – Derivatives Product Determination and Trade Repositories and Derivatives Data Reporting* (“**Model Rules 91-301**”) published on December 6 2012, the Committee gave a brief explanation of the CSA rule-making process. The Working Group notes however that the explanation was limited only to the rule-making process regarding Model Rules 91-301 and how the Committee would evaluate the comments it would receive regarding Model Rules 91-301. The Working Group kindly requests that the Committee consider providing a detailed explanation of the CSA’s rulemaking process in all its future staff consultation papers.

In addition, the Working Group kindly requests that the Committee provide a detailed explanation about how it plans to implement final model provincial rules including how much time it proposes to give market participants to comply?

In connection with timing generally, the Working Group is of the understanding that the Committee has been surprised and/or disappointed with the relatively few comment letters received from industry in connection with the various Consultation Papers published by the Committee to date. The Working Group respectfully draws the Committee’s attention to the fact that most of its members have had their limited internal resources focused on monitoring and complying with Dodd-Frank requirements since before 2010. It was not until the Committee’s recent efforts, particularly since the publication of Model Rules 91-301 in December 2012, to create general public awareness of Canadian derivatives regulatory reform, that most Working Group members became aware of the Committee’s initiatives and desire for industry input. In the Working Group’s view, industry would benefit from an extended comment period after all consultation papers and proposed model rules have been released in order to have an opportunity to assess the implications of the entire proposed new regulatory framework to our businesses on a holistic basis.

² Transparency in this case “refers to public access to information held by government rulemakers as well as information about their decision making”.

³ Public participation “encompasses varied opportunities for members of the public, market participants, businesses and others outside the regulatory agencies to contribute to and comment on proposed rules with the regulators addressing openly why they agree or disagree with the comments made”.

III. SPECIFIC COMMENTS

The Working Group has the following specific substantive comments regarding Derivatives Registration Paper 91-407

Is Registration needed for key derivatives market participants?

The Committee states in Derivatives Registration Paper 91-407 that “it believes it is necessary to **impose registration requirements on key derivatives market participants**” without stating why it holds that belief and why it feels it is necessary to require registration of key derivatives market participants.

In its Discussion Paper, the Canadian OTC Derivatives Working Group, which is composed of some members of the CSA, chaired by the Bank of Canada and tasked (along with other Canadian federal financial agencies) with ensuring that Canada meets its G-20 commitments related to the reform of the OTC derivatives market in Canada, made five recommendations (the “**Five Recommendations**”) that covered five areas of reform as follows:

- i. capital incentives and standards;
- ii. standardization;
- iii. central counterparties and risk management;
- iv. trade repositories and
- v. trading venues

The Working Group respectfully draws the Committee’s attention to the Canadian OTC Derivatives Working Group statements, made in conjunction with the Five Recommendations, that:

“[the Canadian OTC Derivatives Working Group] viewed the initiatives for reform of OTC derivatives markets contained in the G-20 commitments as important to the resilience and stability of the Canadian financial system and concluded that these five recommendations would be enough to implement all elements of the G-20 commitments.”.

Nowhere in the Discussion Paper did the Canadian OTC Derivatives Working Group mention or discuss the need to regulate key derivatives market participants through the implementation of a registration regime.

Further, the CSA, in its first Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada (“**CSA Paper 91-401**”), set out high-level proposals for the regulation of OTC derivatives, but the CSA did not address the issue of the applicability of registration exemptions and postponed the scope of registration requirements to be the subject of future consultations.

The Working Group respectfully requests that the Committee pause and open a consultation process with market participants and the public, as the CSA stated it would do in CSA paper 91-401, and provide a detailed rationale for the Proposals in Derivatives Registration Paper 91-407. Such action would help members of the Working Group, and other market participants, understand the Committee’s

belief that it is necessary to impose registration requirements on key derivatives market participants. The Committee should explain why it holds that belief particularly given that the Canadian OTC Derivatives Working Group did not see the need to recommend imposing a registration regime?

The Working Group also respectfully requests that the Committee's explanation of the Proposals should include a cost-benefit analysis of how the Proposals would impact the market. Specifically the Committee should provide all information about its own projections on the costs: (i) for compliance and risk management personnel; (ii) of the person-hours necessary to comply with the Proposals; (iii) of required technology expenditures; and (iv) any other compliance costs forecast or foreseen by the Committee that market participants may have to bear to comply with the Proposals.

Why is the CSA proposed regulatory regime regarding OTC derivatives going beyond the recommendations made by the Canadian OTC Derivatives Working Group?

The Canadian OTC Derivatives Working Group stated its rationale for making the Five Recommendations contained in the Discussion Paper by saying that: "[Reforms] [to the OTC derivatives market] 'are therefore important to i) reduce systemic risk, ii) improve market efficiency, and iii) improve market integrity and investor protection'. They also said that 'Reforms should be designed with a view to their potential unintended adverse consequences, including those associated with regulatory arbitrage'.

The Working Group respectfully requests that the Committee, as part of the consultation process requested above, provide an explanation to market participants and the public about how the Proposals align with the Canadian OTC Derivatives Working Group's rationale for making the Five Recommendations to reform Canada's OTC derivatives markets.

On the issue of regulatory arbitrage, the Working Group is fearful that implementation of the registration requirements, as currently proposed by the Committee, would put Canadian companies, and particularly Canadian energy companies, at a competitive disadvantage to U.S. energy companies. The Working Group notes that as of the date of this letter no U.S. energy companies have yet been required to register as either a "Swap Dealer" or a "Major Swap Participant". This suggests that the vast majority of energy companies are "end-users" under the Dodd-Frank Act.

By contrast, if the Proposals were implemented as currently proposed, many Canadian energy companies would likely be required to register as "derivatives dealers" or "derivatives advisers", thereby incurring a much greater compliance burden: (i) than their U.S. peers; or (ii) with respect to their Canadian-based derivatives trading activity than with respect to their U.S. based derivatives trading activity; and (iii) for essentially the same type of trading activity on either side of the Canada-U.S. border. The Working Group respectfully submits that these entirely opposing and contradictory results could not have been intended by the G-20 leaders, or by Canadian or U.S. regulators, in respect of the same trading activities and common goals to address similar market risks. In addition, such stark differences will put Canadian energy companies at a competitive disadvantage in cross-border transactions from a cost of business perspective and willingness of foreign counterparties to transact in a Canadian jurisdiction that has an entirely different regulatory regime from other larger and more significant derivatives markets.

The Working Group respectfully asks if the Committee intended such consequences for the Canadian energy sector resulting from the Proposals, and if yes, we would like to understand the reasons for the Committee's proposed more onerous treatment in Canada, than has happened in the U.S. for example, even though both regulatory regimes grew out of the same G-20 commitments in respect of regulation of OTC derivatives markets worldwide.

IV. CONCLUSION

The Working Group supports customized regulation of the OTC derivatives market in Canada that takes into consideration the unique characteristics of Canadian OTC derivatives market participants, in particular Canadian energy companies whose businesses are focused on developing and marketing Canadian natural resources in domestic and global markets. The Working Group also applauds the CSA's efforts to establish a regulatory regime over the OTC derivatives markets in Canada that would bring transparency and ensure efficiency of the markets. We appreciate that the CSA must strike a balance between imposing effective regulation and not inadvertently damaging the ability of Canadian energy corporations to use OTC derivatives to hedge their operational risks and optimize their assets. The Working Group offers its advice and expertise and welcomes the opportunity to work with the CSA in striking such a balance and in connection with crafting an effective and reasonable regulatory regime for OTC derivatives in Canada.

Respectfully submitted,
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PPB

cc: Capital Power Corporation
Direct Energy
Enbridge Inc.
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