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June 17, 2013

British Columbia Securities Commission  
Alberta Securities Commission  
Nova Scotia Securities Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West, Suite 1900, Box 55  
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Dear Sirs / Madames:

**RE: CSA Consultation Paper 91-407 Derivatives: Registration**

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Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") regarding Consultation Paper 91-407 Derivatives: Registration ("CP 91-407") related to the registration and regulation of market participants trading Over-the-Counter derivatives.

Fidelity Investments Canada ULC ("Fidelity Canada") is a fund management company in Canada and part of the Fidelity Investments organization in Boston ("Fidelity Investments"), one of the world's largest financial services providers. Fidelity Canada manages a total of \$74 billion in mutual funds and institutional assets (the "Funds"). It offers approximately 150 mutual funds and pooled funds to Canadian investors.

Fidelity Canada supports the Canadian Securities Administrators Derivatives Committee's (the "Committee") efforts to implement registration requirements as a means to regulate derivative market participants. Fidelity Canada is registered under National Instrument 31-103 ("NI 31-103") as an investment fund manager and portfolio manager ("advisor") in all provinces and territories in Canada, and as a Commodity Trading Manager under the Commodity Futures Act (*Ontario*). As a registrant, Fidelity Canada is subject to many of the regulatory requirements

proposed in CP 91-407 for derivatives. From a practical standpoint, NI 31-103 generally addresses the concerns of the Committee related to compliance and risk management, supervision and oversight. Our primary concerns with the proposed regulations thus relate to elements that are not consistent with the content and scope of registrant obligations under NI 31-103.

Fidelity Canada's responses to the CP 91-407 proposals that apply to Fidelity Canada in its capacity as investment fund manager and advisor are noted below.

### **A. Registration Triggers**

Fidelity Canada appreciates the Committee's consideration on the impact registration might have on investment funds. In our view the application of "business triggers" to investment funds is not appropriate since investment funds are generally not "in the business of trading derivatives" as discussed in CP 91-407. Investment funds are managed and distributed for the benefit of investors and the "business trigger" concept is more appropriately applied to dealers and advisers that might intermediate trades, act as market maker, trade with the intention of being remunerated or compensated, or directly or indirectly solicit derivatives trades or provide advice with respect to derivatives.

### **B. Registration Categories**

We believe the recommendation to implement a derivatives dealer and derivatives adviser registration category are appropriate. While CP 91-407 states "the Committee believes that most investment funds, particularly investment funds that are reporting issuers, will not trigger an obligation to register", we note that investment funds may be caught by a Large Derivative Participants ("LDP") registration category. While we understand the defining characteristics of an LDP are still being assessed by the Committee, CP 91-407 states that it may apply to entities that, in part, maintain a "substantial position in a derivative" and where "the entity's exposure in Canadian derivatives markets results in counterparty exposure that could pose a serious risk to Canadian financial markets or to the financial stability of Canada ..."

If the intent of the LDP registration category is to identify and regulate derivatives users who are "systemically important" but do not otherwise fit into another registration category, we are concerned that investment funds may be caught under the LDP category and subject to regulatory requirements that are inappropriate to the risks associated with derivative use in investment funds. For example, under National Instrument 81-102 ("NI 81-102"), a Canadian mutual fund is not permitted to use leverage, must maintain sufficient asset coverage for all derivative positions, and is subject to counterparty risk monitoring requirements. These requirements serve to mitigate the systemic risk that we believe the LDP category is intending to address.

We acknowledge that the Committee is recommending additional work be undertaken to establish appropriate thresholds for LDP registration and we encourage regulatory authorities to consider finding an appropriate balance between the systemic risk mitigation intent of the LDP registration category and the manner in which derivative risk is managed and mitigated in investment funds. In our view it is not appropriate to introduce a registration category specific to investment funds when the advisers and dealers responsible for providing derivatives advice and trading to an investment fund are themselves required to register.

### C. Proficiency

We note that the Committee proposes that registrants “have procedures to ensure that all of their directors, officers, employees or agents involved in trading or advising on derivatives, including supervisors and managers of those responsible for trading in or advising activity, have the appropriate education, training and experience to carry out their responsibilities.” We do not think it appropriate to require derivatives proficiency for all directors and officers, and recommend that the Committee narrow the scope of this proposal to include only those responsible for providing advice on, or trading in, derivatives and those responsible for the direct supervision of those individuals. While it is incumbent on directors to oversee the management of a firm’s derivatives program, we consider it impractical and inappropriate to expect directors to fulfill derivatives course requirements or be required to comply with a proficiency standard specific to derivatives. The role of a director is to provide oversight, ensure firms implement appropriate policies and procedures, and ensure those engaged in advising activities at the firm have the appropriate knowledge and experience relative to derivatives use. The director’s role is not to act in a capacity where they are reappraising decisions made by a portfolio advisor. In addition, introducing proficiency requirements will reduce the number of directors available to portfolio advisors thus negatively impacting overall governance effectiveness.

Due to the complex nature of derivative instruments and the derivatives market generally, we agree that registered entities should establish minimum proficiency standards to ensure the prudent use and oversight of derivatives. In our view, and based on the current registration requirements under the *Commodity Futures Act (Ontario)*, a prescriptive regulatory approach to proficiency may not effectively address the risks associated with derivatives use in all circumstances. Alternatively, we suggest that responsibility for defining proficiency standards and assessing the proficiency of those engaged in derivatives activity rest with a registrant’s Board of Directors. However, general guidance from regulatory authorities as to what constitutes a minimum proficiency standard with respect to derivatives may be helpful if proficiency is to be a prerequisite for registration.

### D. Capital, Margin, Insurance and Record Requirements

As we await further recommendations from the Committee relative to capital requirements for derivatives users, we recommend that no additional capital requirements be imposed on derivatives advisors and investment fund managers already required to maintain minimum excess capital under NI 31-103. We acknowledge that maintaining sufficient capital is a key element in seeking to ensure stability in the derivatives market, but as noted above, mutual funds use derivatives in a non-levered manner and in complying with NI 81-102 are thus able to fulfill their obligations under each derivatives contract. As such, we recommend that investment funds subject to NI 81-102 and firms registered under NI 31-103 be explicitly excluded from any proposals related to providing additional capital.

We also recommend that the Committee consider NI 31-103 provisions related to margin, insurance and recordkeeping and seek to minimize or eliminate inconsistencies between NI 31-103 and proposed derivatives regulation. In our view, NI 31-103 requirements adequately address the risks associated with derivatives use, and any additional requirements may introduce unnecessary cost through added complexity to existing compliance and business practices.

## **E. Compliance Systems and Internal Business Conduct Requirements**

We agree with the Committee's recommendation that derivatives registrants establish, maintain and apply compliance and risk management systems appropriate to their derivatives business and note this requirement is consistent with the Compliance System requirements in NI 31-103. As such, we recommend that registered firms subject to NI 31-103 be permitted to rely on compliance with NI 31-103 provisions to satisfy derivatives regulatory requirements. In our view the NI 31-103 Compliance System requirements serve as an appropriate framework for addressing the risks associated with derivatives use. We also recommend that the characterization of compliance programs as "robust" in CP 91-407 be excluded in any proposed rule as the term is subjective and the standard is unclear.

We agree that board-level approval of compliance and risk management systems and ongoing reporting on actions pursuant to derivatives policies and procedures is appropriate. However, we note that in the investment fund context under NI 31-103, the compliance system requirement applies to registered firms, not investment funds themselves and we ask that the Committee consider applying the compliance system requirements to firms that provide derivatives services to an investment fund, not the fund itself under registration as an LDP or otherwise.

We also note that the Committee recommends that each registrant "will be required to prepare a report describing the registrant's derivatives activities, their derivatives compliance and risk management systems and issues related to derivatives compliance and risk management for presentation to the registrant's board" and that "a copy of this report should be filed with the market regulators in each jurisdiction in which it is registered after it has been approved by the registrant's board." Under NI 31-103, registrants are required to make annual compliance presentations to their boards that include an assessment of the registrants' compliance and risk management systems. We strongly oppose the proposal that a similar report on derivatives programs be made public through a filing with regulatory authorities. Compliance system and control reporting is key to the effective oversight of registrants, and we consider the contents of these reports should be available only for the rigorous review of boards, and to regulatory authorities upon request. We encourage the Committee to consider alternative options including the provision of a certificate of compliance or other such assurance to regulatory authorities.

## **F. Appointment of an Ultimate Designated Person, Chief Compliance Officer and Chief Risk Officer**

We agree that derivatives registrants should appoint and register an Ultimate Designated Person ("UDP") and Chief Compliance Officer ("CCO") provided the responsibilities assigned to these roles are consistent with the UDP and CCO requirements under NI 31-103. In the investment funds context, we also agree with the proposal that where derivatives use is not a "primary business" registrants have flexibility with respect to assigning derivatives UDP responsibilities. However, we ask that this flexibility not be based solely on "the arm of the business that conducts derivatives trading or advising". Derivatives may be used very selectively in investment funds and in order to maintain appropriate levels of proficiency and streamline supervision processes, advisor firms should be able to assign derivatives UDP responsibility according to where the expertise resides in their organization, consistent with the UDP proficiency principle for securities in NI 31-103.

We also agree that derivative registrants should appoint and register a derivatives CCO, and encourage the Committee to ensure the responsibilities of the derivatives CCO are consistent with those under the securities framework in NI 31-103. For firms currently registered under NI 31-103, we recommend they be permitted to rely on compliance with NI 31-103 CCO registration provisions to satisfy derivatives CCO requirements.

Under NI 31-103, CCO's are responsible for "establishing a system of controls and supervision sufficient to ... manage the risks associated with its business in accordance with prudent business practices", and the appointment and registration of a derivatives Chief Risk Officer ("CRO") is not required. While in principle we agree with the premise of assigning responsibility for risk monitoring and management relative to the use of derivatives, we encourage the Committee to clarify how the CCO and CRO roles and responsibilities related to risk management might differ.

CP 91-407 does not propose proficiency requirements for the derivatives UDP, CCO and CRO roles. As noted above, we suggest that responsibility for defining proficiency standards and assessing the proficiency of the UDP, CCO and CRO rest with a registrant's Board of Directors. General guidance from regulatory authorities as to what constitutes a minimum proficiency standard for the UDP, CCO and CRO with respect to derivatives may be helpful if proficiency is to be a prerequisite for registration.

#### **G. Foreign Derivatives Advisors**

Fidelity Canada agrees with the Committee's recommendation that foreign derivatives advisors be required to register in Canadian jurisdictions where they carry on business but be exempted from specific regulatory requirements in Canada where they are subject to an equivalent regulatory regime in their local jurisdiction.

#### **H. Conclusion**

Fidelity Canada supports the Committee's efforts to establish a registration regime for derivatives market participants in order to implement and enforce consistent regulatory standards and address systemic risk issues on an ongoing basis. It is evident throughout CP 91-407 that the Committee has considered existing regulatory frameworks for securities in making its recommendation. While the objective of implementing a derivatives registration regime is clear, we encourage the Committee to consider granting exemptions to firms required to comply with the same provisions in the securities framework (i.e. NI 31-103) on the basis that these firms are already required to establish registration, compliance and risk programs that are substantively the same as those contemplated in CP 91-407.

We thank you for the opportunity to comment on these matters. As always, we are more than willing to meet with you to discuss any of our comments.

Yours truly,



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Manager, Investment Compliance

- c.c. **Rob Strickland, President**  
**W. Sian Burgess, Senior Vice-President, Head of Legal and Compliance, Canada**  
**Fidae Abbas, Vice-President, Compliance, Canada**