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July 10, 2013

John Stevenson, Secretary,
Ontario Securities Commission
20 Queen Street West
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Toronto, Ontario M5H 3S8

Sent via email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
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Sent via email: consultation-en-cours@lautorite.qc.ca

Dear Sir and Madame,

RE: CSA Consultation Paper 91-407 and Proposed Ontario Securities Commission Rule 91-506

We are writing in response to the request for comments to CSA Consultation Paper 91-407 on Derivatives Registration and Proposed Ontario Securities commission Rule 91-506, Derivatives: Product Determination.

Summary of Submission

In this submission, we represent our clients who are foreign exchange dealers and other non-bank entities in the business of providing foreign exchange services to individuals and corporations (**"foreign exchange dealers"**). The overall purpose of regulating OTC derivatives, as stated in Consultation Paper 91-401, is to better control systemic risk in the global financial system. Canada, together with other members of the G20, has committed to take part in efforts to reform the OTC markets by improving transparency, standardizing trading and enhancing reporting to regulatory authorities. Due to the nature of the business of foreign exchange dealers, and the small volume of transactions, we submit that the regulation of foreign exchange dealers as derivatives registrants will have negligible impact on mitigating risk in the Canadian and global financial systems. We believe that because of their relative size and level of complexity, the activities of foreign exchange dealers pose virtually no risk to the OTC derivatives market.

On the other hand, regulations requiring registration as derivatives dealers will result in very real hardship to many foreign exchange dealers, particularly those who operate as small businesses. They will be unable to meet the proposed capital, proficiency and compliance requirements that a securities registration would entail.

We therefore respectfully request that the CSA Derivatives Committee give consideration to ensuring that foreign exchange dealers do not become subject to securities registration. The balance of this letter expands on the foregoing.

Business of Foreign Exchange Dealers

Foreign exchange dealers provide a range of services to their clients. The business of foreign exchange dealers ranges from the operation of currency exchange kiosks located in airports, duty free shops and tourist areas to the provision of foreign exchange services to businesses and other enterprises who do businesses overseas. Foreign exchange dealers are registered with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) as a "money services business" or MSB. MSBs are subject to regulation under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and the regulations made thereunder. Unlike deposit-taking financial institutions, foreign exchange dealers are not subject to any minimum capital or other similar prudential regulation. The purchase and sale of currency is not a trade in a security under securities legislation.[1]

In the simplest transactions, foreign exchange dealers exchange currency in the form of bank notes and coins and cash travelers cheques. Foreign exchange dealers may also remit funds on behalf of their clients in foreign currencies; for example, a Canadian with a condominium in Florida may ask a foreign exchange dealer to remit property taxes or utility payments to the local authority on his or her behalf. Foreign exchange dealers located in border areas facilitate businesses and enterprises who accept payments in foreign currency. For example, a restaurant or retailer on the Canadian side of the border may accept payment in U.S. cash, and the foreign exchange dealer may purchase the U.S. cash in exchange for Canadian dollars.

More sophisticated product offerings are available for clients who do business with foreign suppliers or purchasers. An importer for example may need to settle a trade payment in 30 days time. In that case, the importer may agree with the foreign exchange dealer to purchase the required quantity of the foreign currency today for delivery in 30 days time.

Foreign exchange dealers frequently enter into forward currency contracts and foreign currency swaps in the course of their business to hedge risk and for client facilitation. A dealer who has agreed with his client to pay a trade debt in British Pounds Sterling in 30 days time will hedge the exposure by entering into a currency forward or swap with a bank or other counterparty. In these "back to back" transactions, the foreign exchange dealer is effectively hedging the FX risk on behalf of the client. The client typically chooses to work with a foreign exchange dealer because the rates that the client is able to obtain from the foreign exchange dealer are much more advantageous than those available through a commercial bank. Smaller and mid-size businesses are often unable to obtain reasonable foreign exchange rates through banks, and they are also often unable to hedge their currency exposure on commercially reasonable terms. Our clients have observed instances where banks are unable or unwilling to provide these services to small and mid-size enterprises at rates such enterprises can afford. Without foreign exchange dealers, such clients would find it difficult or even impossible to effect payments to foreign suppliers.

Foreign Exchange Dealers do not "Cash Settle"

Virtually every foreign exchange transaction entered into by a foreign exchange dealer is intended to, and does, result in "physical delivery" of the currency. The foreign currency forward contracts and swaps are used to hedge against relatively short-term fluctuations in exchange rates, and are not used for

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[1] Ontario Securities Commission Staff Notice 91-702 stated that contracts for difference (CFDs) and "foreign exchange contracts and similar OTC derivative products" raised investor protection concerns. The Staff Notice clarified staff's view that CFDs were "investment contracts" and hence "securities' for purposes of Ontario securities laws and were also "derivatives". The Staff Notice, which is stated to be an interim measure pending the adoption by the CSA of a harmonized approach to the regulation of OTC derivatives, did not specify other "forex contracts and similar OTC derivatives" which would be considered as "securities" or "derivatives" under Ontario securities law.

"investment" or for speculation. As stated, clients of foreign exchange dealers are looking for an efficient and cost effective means to manage their accounts payable, and receivable, in a foreign currency. They do not enter into the contracts for amounts in excess of what is needed to meet payment obligations, with the intent of profiting from exchange rate fluctuations. Hence it is difficult to view the FX contracts as an "investment contract".

Volume of Transactions

The volume of FX transactions undertaken by non-bank foreign exchange dealers is vanishingly small in comparison with the total volume of FX transactions which take place globally through financial institutions. Foreign exchange dealers (MSBs) are not comparable to commodity producers such as oil companies or gold mining companies, who are selling forward their production in contracts in the tens or hundreds of millions of dollars, where contracts which fail to settle could represent significant risk to the counterparties and to the financial system. Foreign exchange dealers are invariably offered forward facilities by banks and financial institutions only on restricted terms, with credit limits conservatively applied and margins and collateral security requirements for the facilities strictly monitored and enforced. It is almost unimaginable that the activities of foreign exchange dealers would pose any measurable threat to the stability of the Canadian or global financial system.

Our concern

CSA Consultation Paper 91-407 on Derivatives Registration, combined with Proposed OSC Rule 91-506 *Derivatives: Product Determination* and Proposed OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* could result in foreign exchange dealers having to become registered as derivatives dealers.

In CSA Consultation Paper 91-407, the CSA Derivatives Committee (the Committee) proposes that a variety of activities be considered to "be a trade in a derivative", including:

- entering into a derivatives contract;
- material amendments to a derivatives contract;
- assignment of any or all rights under a derivatives contract;
- termination of a derivatives contract;
- novation of a derivatives contract, except where the novation is by a clearing agency; and
- other activities in furtherance of a trade.

Would a currency forward of the type routinely entered into by foreign exchange dealers be considered a 'trade in a derivative"?

The commentary to Proposed OSC Rule 91-506 provides the view of regulators with respect to FX spot transactions. Appendix A notes that commentators suggested that deliverable foreign exchange forward contracts be excluded from the definition of "derivative" provided that there is an intention to physically deliver the foreign currency. The Committee has declined to follow that recommendation, stating its belief that all deliverable foreign exchange forward transactions that are not settled within prescribed timelines should be treated as "derivatives".

As currently proposed, a contract or instrument is prescribed <u>not</u> to be a derivative only if it is:

(c) a contract or instrument for the purchase and sale of currency that,

(i) except where all or part of the delivery of the currency referenced in the contract or instrument is rendered impossible or commercially unreasonable by an intervening event or occurrence not reasonably within the control of the parties, their affiliates or their

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agents, requires settlement by the delivery of the currency referenced in the contract or instrument,

(A) within two business days, or

(B) after two business days provided that the contract or instrument was entered into contemporaneously with a related security trade and the contract or instrument requires settlement on or before the relevant security trade settlement deadline,

(ii) is intended by the counterparties, at the time of the execution of the transaction, to be settled by the delivery of the currency referenced in the contract within the time periods set out in subparagraph (i), and

(iii) does not allow for the contract or instrument to be rolled over.

So a currency forward contract of the type routinely entered into by foreign exchange dealers, because it does not settle within two business days, or the contract may be "rolled", would be considered to be a "derivatives contract".

And since foreign exchange dealers commonly enter into these types of contracts with their clients, they would likely trip the business trigger for trading. Also, these contracts are entered into by the foreign exchange dealers with the intention of being remunerated or compensated; i.e. with the intention of making a spread or profit, again giving rise to the assumption that the activity is undertaken for a business purpose and thus triggering the registration requirement.

Foreign Exchange Dealers should be exempt from registration as derivatives dealers

It is our view that the activities of foreign exchange dealers should not be considered to be registrable activity under any registration regime such that any derivatives dealer or derivatives adviser registration will be required. If a foreign exchange dealer otherwise meets the definition of "large derivative participant" through aggregate derivative exposure, then the foreign exchange dealer would comply with the registration requirements applicable to LDPs. Please note however that we believe that deliverable foreign currency forward transactions should be excluded from what gets counted as aggregate gross notional exposure in the determination of the threshold for registration and reporting.

Foreign exchange dealers provide a valuable service to an important and underserved economic and demographic segment: individuals and small and mid-sized businesses who are often unable to access foreign currency services at large financial institutions conveniently and at affordable rates. We do not believe that the business carried on by foreign exchange dealers gives rise to investor protection concerns which must be addressed by a registration regime applicable to firms and individuals. We emphasize that clients of foreign exchange dealers are not relying on the dealers for investment advice or financial advice. A currency transaction that does not settle within two days should not automatically turn the transaction into a "derivative contract", and the provider into a securities registrant. Clients of foreign exchange dealers are looking for dependable and cost efficient execution of their foreign currency transactions; they are not placing reliance on the foreign exchange dealer to place them into a suitable investment. We are unaware of instances of clients of foreign exchange dealers who have been harmed by having been sold an "unsuitable" product, and if any such instances have come to the attention of the CSA, we would welcome an opportunity to discuss the situation.

We therefore respectfully request that the Committee give consideration to ensuring that foreign exchange dealers do not become subject to securities registration.

We would be pleased to discuss the foregoing further with you or to respond to any questions you may have.

Yours truly,
MILLER THOMSON LLP

Per:

Susan Han
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