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VIA EMAIL

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John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

Dear Mr. Stevenson:

Re: Proposed OSC Rule 91-506 Derivatives: Product Determination and Proposed Companion Policy 91-506CP

We appreciate the opportunity to comment on the proposed Ontario Securities Commission (**OSC**) Rule 91-506 *Derivatives: Product Determination* (the **Scope Rule**) and the proposed Companion Policy 91-506CP on behalf of our clients who are non-bank foreign exchange dealers and are registered with the Financial Transactions and Report Analysis Centre of Canada (**FINTRAC**) as money services businesses (**MSB**).

Our comments relate specifically to paragraph 2(c) of the Scope Rule, which prescribes a contract for the purchase and sale of currency not to be a derivative within the meaning of the Ontario *Securities Act* only if such contract requires physical delivery of the currency within two business days.¹ We understand that any currency exchange contracts that do not fall within the exemption under paragraph 2(c) of the Scope Rule will be subject to reporting requirements under the proposed OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* (the **TR Rule**).

We respectfully submit that the limitation of two business days for the physical delivery in currency exchange transactions will have the effect of extending the application of the reporting requirements under the TR Rule to a large number of MSBs operating in Canada, many of which are small businesses engaged in low-volume non-speculative transactions. The application of the reporting requirements under the TR Rule to MSBs, in our respectful view, is unwarranted given the non-speculative nature of foreign exchange services offered by most MSBs and will result in undue hardship and excessive compliance costs to MSBs operating in Canada. Our reasoning for this submission is as follows:

1. MSBs offer a wide range of foreign exchange services that are aimed at addressing the personal and business needs of their customers for foreign currency in cross-border dealings. The foreign exchange transactions offered by MSBs are rarely speculative in nature. They involve spot or forward arrangements whereby a principal is exchanged at a predetermined settlement exchange rate by physical delivery. After the settlement exchange rate has been predetermined, the Canadian

¹ Subject to the exception in clause 2(c)(i)(B).
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dollar amount to be paid or received by the Canadian counterparty is known from the outset and therefore is inherently not speculative. There are no contingent outcomes in these transactions as cash-flows are known at the outset. The risk in the transaction lies with the MSB, not its customer. Although currency transactions that are settled by delivery within two business days would be exempt under paragraph 2(c) of the Scope Rule, those MSBs that offer foreign exchange services with longer delivery dates would fall within the TR Rule requirements. By way of example, an MSB may make a payment in a foreign currency to an overseas contractor or supplier of its business customer in exchange for a payment in Canadian currency to be made by the customer to the MSB in Canada after a specified period of time, such as a week or a month later, at a predetermined rate. An MSB may also make a cross-border foreign currency payment on behalf of a non-business customer, such as an individual who purchases a car or a house in a foreign jurisdiction, who agrees to make a payment to the MSB in Canadian currency at a predetermined rate after a specified period of time that is longer than two business days.

In our view, the size of MSBs and the volume and nature of foreign exchange transactions offered by MSBs are such that they do not pose any significant systemic risk to Canadian financial markets, the regulation of which is one of the objectives of introducing the TR Rule. In addition, given that foreign exchange services offered by most MSBs are not speculative to their customers, the regulation of speculative derivatives contracts and instruments, as a policy underlying the introduction of the TR Rule, does not apply in this context.

2. According to a Typologies and Trends Report² published by FINTRAC, as of 2010, 770 businesses have been registered with FINTRAC as money services business that provide foreign exchange services to Canadians. While the MSB sector in Canada includes a number of large companies, many of the registered MSBs are “very small independent businesses with no employees beyond the owner, and which are engaged in very low volumes of transactions.”³ These entities, as we discuss below, are subject to reporting, registration, record-keeping and other obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the **PC Act**) and associated regulations. Subjecting MSBs to reporting obligations under the TR Rule would result in an excessive regulatory burden to these businesses and can interfere with their ability to provide foreign exchange service to a broad sector of Canadians that comprises many small businesses and individuals.
3. MSBs in Canada are subject to a robust regulatory regime under the PC Act and associated regulations, which require MSBs to register with FINTRAC, report transactions, identify customers and determine their beneficial ownership and keep records in respect of these transactions. More particularly:
 - a. The PC Act requires that MSBs register with FINTRAC before they can carry on business in Canada. Where an MSB or any of its directors, senior officers or major shareholders is convicted of certain listed offences under the *Criminal Code*, the registration of such MSB is prohibited under the PC Act.

² FINTRAC (July 2010), *Money Laundering and Terrorist Financing (ML/TF) Typologies and Trends for Canadian Money Services Businesses*; available online: <http://www.fintrac-canafe.gc.ca/publications/typologies/2010-07-eng.pdf>.

³ *Ibid* at p 3.
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- b. Registered MSBs are required to report to FINTRAC cross-border electronic fund transfers of CAD\$10,000 or more, as well as cash transactions involving a receipt of CAD\$10,000 or more.
- c. Registered MSBs are required to report to FINTRAC suspicious transactions and transactions involving terrorist-owned or controlled property.
- d. MSBs have detailed record-keeping obligations in respect of threshold transactions, including a requirement to keep records for at least 5 years in respect of foreign exchange transactions. The records that an MSB is required to keep in respect of a foreign exchange transaction include (i) the date, amount and currency of the purchase or sale, (ii) the method, amount and currency of the payment made or received and (iii) the individual's name, address and date of birth, where the transaction is made by an individual for \$3,000 or more.
- e. MSBs are required to confirm the identity and verify the beneficial ownership information of their customers in respect of threshold transactions.
- f. MSBs operating in the Province of Quebec are also subject to substantially similar provincial regulation under the Quebec *Money-Services Businesses Act*.

The foregoing requirements under the PC Act introduce a significant level of transparency and accountability to the business of MSBs and regulate in large part the market conduct of MSBs operating in Canada, in addition to addressing the money-laundering and terrorist-financing risks associated money transmittance transactions. The regulatory regime under PC Act, therefore, addresses some of the other stated objectives of the TR Rule and the Scope Rule, namely, the improvement of transparency and the ability to identify and address the risk of market abuse.

Based on the foregoing, we submit that the current wording of paragraph 2(c) of the Scope Rule will bring many MSBs within the scope of the TR Rule and will subject them to substantial compliance costs, which, in our respectful view, are unjustified, given the non-speculative nature of services offered by most MSBs, the insignificant systemic risk that MSBs pose to Canadian and international financial markets and the fact that MSBs are adequately regulated in Canada under the federal PC Act. We therefore request that the Commission reconsider limiting the exemption under paragraph 2(c) to currency contracts with physical delivery within 2 days or address specifically the application of paragraph 2(c) to non-bank MSBs registered with FINTRAC. The Commission may consider extending the exemption under paragraph 2(c) to not only currency transactions that require physical delivery of currency within two business days, but also to those contracts under which the exchange rate has been predetermined at the time of, or within two days of, entering into the currency transaction, notwithstanding the actual settlement date.

Yours very truly,



Jacqueline Shinfield