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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

August 30, 2017

Dear Sirs/Mesdames:

**Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("NI 93-101") and Related Proposed Companion Policy (the "Companion Policy", and together with NI 93-101, the "Proposed Rules")**

**INTRODUCTION**

The Canadian Market Infrastructure Committee ("**CMIC**") is pleased to provide this comment letter on the Proposed Rules.

CMIC was established in 2010, in response to a request from Canadian public authorities,[1] to represent the consolidated views of certain Canadian market participants on proposed regulatory and legislative changes in relation to over-the-counter ("**OTC**") derivatives. The members of CMIC who are responsible for this letter are: Alberta Investment Management Corporation, Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Citigroup Global Markets Inc., Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan Trust Fund, HSBC Bank Canada, Invesco Canada Ltd., JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation,

[1] "Canadian public authorities" means representatives from Bank of Canada, Canadian Securities Administrators, Department of Finance and Office of the Superintendent of Financial Institutions ("**OSFI**").

Morgan Stanley, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Public Sector Pension Investment Board, Royal Bank of Canada, Sun Life Financial, The Bank of Nova Scotia and The Toronto-Dominion Bank.

CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian OTC derivatives market. The membership of CMIC has been intentionally designed to present the views of both the 'buy' side and the 'sell' side of the Canadian OTC derivatives market, including, but not limited to, both domestic and foreign owned banks operating in Canada as well as major Canadian institutional market participants (including a number of major pension funds) in the Canadian derivatives market. This letter reflects the consensus of views within CMIC's membership about the proper Canadian regulatory and legislative regime applicable to the OTC derivatives market.

In providing our comments on the Proposed Rules, CMIC notes the difficulty in fully assessing the Proposed Rules in the absence of reviewing the proposed derivatives dealer registration rules (the "**Registration Rules**"). Accordingly, CMIC reserves the right to provide further comments if the Registration Rules give rise to any further issues relating to the Proposed Rules. In addition, given the magnitude of the combined effect of the Proposed Rules and the Registration Rules, CMIC submits that the regulators and market participants would benefit from an additional joint comment period after the regulators have fully reviewed and considered all comments received on both the Proposed Rules and the Registration Rules.

**EXECUTIVE SUMMARY**

Our comments in this letter generally fall within four principal themes:

1. Duplication of Existing Rules: The Proposed Rules require a robust public policy justification and comprehensive regulatory impact assessment. Many provisions in the Proposed Rules duplicate existing laws and regulations. Accordingly, we recommend that they be deleted as they are unnecessary or, in the alternative, that substituted compliance be granted.

2. OTC Derivatives Markets vs Securities Markets: There are fundamental differences between the securities markets and the OTC derivatives markets. We recommend that certain rules be amended or deleted in order to reflect those fundamental differences.

3. Harmonization: The Canadian OTC derivatives markets is a part of a global market that relies heavily on global participants. Accordingly, we recommend that the Proposed Rules be harmonized with global rules, particularly with the Commodity Futures Trading Commission's ("**CFTC**") rules[2] under Dodd-Frank.[3]

4. Timing of Implementation: Given the proposed review and re-assessment of the CFTC rules and the fact that the Securities and Exchange Commission's business conduct rules are not in force, we recommend delaying the implementation date of the Proposed Rules to better ensure harmonization.

Here is a brief summary of our recommendations:

- We recommend that the regulators exempt the inter-dealer market from the Proposed Rules.

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[2] The CFTC's business conduct rules are principally located in the *Code of Federal Regulations*, Title 17, Chapter I, Part 23 ("**17 CFR Part 23**"), available at: https://www.ecfr.gov/cgi-bin/text-idx?SID=dbb5c5a633932a41e806929529662e54&mc=true&node=pt17.1.23&rgn=div5.

[3] *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub.L. 111-203, H.R. 4173 ("**Dodd-Frank**"), available at: http://www.cftc.gov/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf.

- Due to the maturity and transparency of the foreign exchange market, we recommend an exemption whenever a derivatives firm adheres to a global foreign exchange code of conduct and transacts in foreign exchange transactions.

- We recommend that the definition of "eligible derivatives party" be revised to:

  - lower the threshold in paragraph (m) for a non-individual to $10 million;
  - remove the knowledge and experience requirements under paragraphs (m) and (n);
  - add a hedger category; and
  - add "permitted client" as defined under NI 31-103[4] as an additional category.

  As a related point to the definition of "eligible derivatives party", we recommend that Section 7(2) of the Proposed Rules be deleted in order to remove the waiver requirement for individuals and that Section 7(3) of the Proposed Rules be deleted in order to apply the two-tiered approach to an adviser of a managed account for an eligible derivatives party.

- We recommend that the business trigger commentary regarding the definition of "derivatives dealer" be amended to limit the activity to market making activity.

- The use and investment of derivatives party assets should be expressly limited to collateral and subject to existing margin rules, or other applicable rules, and otherwise be subject to bilateral contractual arrangements with respect to re-hypothecation.[5]

- The proposed senior derivatives manager regime is not appropriate in Canada as it relates to federally-regulated financial institutions ("**FRFIs**") and therefore should not be applicable as it results in oversight fragmentation.

- We recommend substituted compliance for almost all the other provisions for both domestic financial institutions regulated by OSFI and for foreign derivatives dealers as outlined in detail in the attached Schedule A and Schedule B.

This letter will begin by setting out several general comments that elaborate on the four principal themes mentioned above. We will then respond to specific questions raised by the regulators in the Proposed Rules. This is followed by our additional comments relating to provisions that were not specifically raised by the regulators. Finally, in Schedule A and B of this letter, we provide the results of our extensive analysis relating to existing rules.

**GENERAL COMMENTS**

Duplication of Existing Rules: CMIC is supportive of appropriate business conduct rules in the OTC derivatives markets. However, in CMIC's view, there are many provisions of the Proposed Rules that are duplicative of, or already sufficiently addressed in, existing Canadian law, particularly for FRFIs. In this letter, we will highlight and discuss these provisions and present arguments as to why they are duplicative and should be removed from the Proposed Rules because they are unnecessary. CMIC submits that since the Proposed Rules change the cost of compliance for businesses, the Proposed Rules fall within the scope of the Ontario Regulatory Policy[6] and equivalent policies in other

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[4] National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy3/PDF/31-103__NI___July_15__2016/.

[5] As used in this letter, the term "**re-hypothecation**" includes re-use and re-pledging.

[6] Ontario Regulatory Registry, *Ontario Regulatory Policy* (the "**Ontario Regulatory Policy**"), available at http://www.ontariocanada.com/registry/downloads/Ontario%20Regulatory%20Policy.pdf. We note that each other Province is bound by similar rules and/or principles.

provinces[7]. The Ontario Regulatory Policy creates more open and responsive ways for government to work with business to deliver results, while protecting the public interest. One of the principles under the Regulatory Policy is that duplication of regulation should be minimized, where appropriate. As noted above, it is CMIC's view that the Proposed Rules significantly overlap with existing rules that are operating effectively and, in many cases, in a different manner. As a result, we do not believe the Proposed Rules are necessary given the effectiveness of existing regulations. That said, although the protection afforded to derivatives counterparties under the existing rules on a principled basis is the same as the Proposed Rules, the Proposed Rules are not identical to existing rules, which means that market participants will need to spend considerable time and resources understanding the nuances between the Proposed Rules and the existing rules. Such duplication results in inefficiency because market participants need to keep track of any amendments and case law with respect to two or more sets of rules and incur associated implementation, outreach, compliance and monitoring costs. Thus, if the Proposed Rules are implemented, notwithstanding our concerns, CMIC urges that they be harmonized to the fullest extent possible with applicable existing rules and that the CSA periodically revise the Proposed Rules to accommodate developments in the existing rules to maintain harmonization.

Another principle of the Ontario Regulatory Policy is that proposed regulations must respond to a clearly identified need for regulation. While other international jurisdictions have imposed business conduct rules for OTC derivatives, it is CMIC's view that a robust public policy justification has not yet been presented that these separate rules are necessary in Canada. A recent IOSCO report[8] indicates several factors in wholesale markets that may give rise to potential risks of market misconduct, including decentralized market structures and the opaque nature of markets. These factors have been addressed in the OTC derivatives market through recent reforms such as trade reporting, public dissemination, electronic trading platforms, mandatory clearing and uncleared margin. Other factors identified by IOSCO such as the size and organizational complexity of large market participants and the corresponding need for appropriate governance are already very effectively addressed in the Canadian OTC derivatives market through existing prudential and market conduct rules. Accordingly, we do not believe that the factors identified by IOSCO are relevant in the Canadian OTC derivatives market, nor have such factors been demonstrated to give rise to misconduct in this market. In this regard, to our knowledge in the Canadian OTC derivatives market there have been no appreciable or material examples of market misconduct by banks or other derivatives dealers in Canada. In addition, CMIC notes that market conduct was not listed as one of Canada's G-20 commitments.[9] To our knowledge, Canadian regulators have not presented clear

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[7] British Columbia, Ministry of Small Business and Red Tape Reduction, *Regulatory Reform Policy*, available at http://www2.gov.bc.ca/assets/gov/government/about-the-bc-government/regulatory-reform/pdfs/final_regulatory_reform_policy_-_aug_2016.pdf; Alberta, Regulatory Review Secretariat, *Regulatory Excellence*, available at https://open.alberta.ca/dataset/79a65442-7aca-4287-b8c5-b5c324f590bd/resource/e919b4bb-acb0-4147-a957-27546b657c0b/download/zz-6080672-2012-RegulatoryExcellence.pdf ; Saskatchewan, Ministry of the Economy, *Annual Regulatory Modernization Progress Report for 2015-2016*, available at http://publications.gov.sk.ca/documents/310/93580-2015-16RegulatoryModernizationProgressReportECONOMY.pdf ; *The Regulatory Accountability Act* (Manitoba), SM 2017, c. 21, s. 4, available at http://web2.gov.mb.ca/laws/statutes/2017/pdf/c02117.pdf ; *Regulations Act* (Quebec), CQLR 1986, c R-18.1, s. 5, available at http://legisquebec.gouv.qc.ca/en/pdf/cs/R-18.1.pdf ; Newfoundland and Labrador, New Brunswick, Nova Scotia and Prince Edward Island have each passed legislation creating a Joint Office of Regulatory Affairs and Service Effectiveness, available at https://novascotia.ca/regulatoryopportunity/premiers-%20charter.asp.

[8] Section 2.3, IOSCO Task Force Report on Wholesale Market Conduct, June 2017, available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD563.pdf

[9] G-20, *Leaders' Statement: The Pittsburgh Summit*, available at: https://www.oecd.org/G-20/summits/pittsburgh/G-20-Pittsburgh-Leaders-Declaration.pdf.

evidence that it is necessary for these business conduct rules to apply in particular to such a broad range of market participants.

A further principle of the Ontario Regulatory Policy states that a clear assessment of the total costs and benefits of proposed regulations should be undertaken, and should be based on the risks posed in the absence of regulation, taking into account the overall impact on the competitiveness of those subject to the regulation. While the notice accompanying the Proposed Rules includes a section on Anticipated Costs and Benefits, CMIC submits that this analysis has not taken into account a number of factors. With respect to "benefits", the analysis provides that the Proposed Rules offers protections not only to retail market participants but also to "large market participants whose derivatives losses could impact their business operations and potentially the Canadian economy more broadly". It is not clear that market participants, and in particular, "large market participants" are in need of further protection other than that already afforded to them under existing regulation. Further, the analysis provides that the Proposed Rules "fills a regulatory gap" for certain derivatives firms that are not subject to business conduct regulation and oversight. While that may be the case for some market participants, it is CMIC's view that firms representing the overwhelming majority of OTC derivatives market participants, i.e. domestic and foreign banks and swap dealers, are already subject to business conduct regulation and oversight, either through prudential regulators or under foreign business conduct rules.

In terms of "costs", CMIC strongly submits that the analysis does not take into account the additional client outreach that will be required, the associated direct costs, the challenges involved and the consequential effects. It is highly likely that derivatives dealers will need to amend existing documentation to obtain representations in order to comply with the Proposed Rules and/or would have to conduct due diligence to ensure counterparties have the status of an "eligible derivatives party" ("**EDP**"). As CMIC bank members' experiences with implementing the OTC derivatives trade reporting rules demonstrate, there are significant challenges associated with obtaining such representations from clients, especially those located outside of Canada. Certain foreign market participants, regardless of size, will only respond to requests from major jurisdictions, such as the US and Europe, which means that an inordinate amount of time is spent following-up on client outreach correspondence. Further, market participants are fatigued by the burden of regulatory compliance in multiple jurisdictions. Non-Canadian derivatives firms are increasingly weighing the burden of complying with Canadian-specific regulations in deciding to continue transacting with Canadian counterparties. While the "costs" section of the analysis recognizes the possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Rules, it cites the fact that substituted compliance will significantly reduce such compliance costs. CMIC submits that a significant reduction of such compliance costs is unlikely because foreign derivatives firms will need to spend the time and money analyzing the Canadian rules to implement and ensure compliance with the provisions for which substituted compliance has not been granted. This may dissuade them from transacting with Canadian market participants, as discussed further below under "Harmonization" on page 4.

Accordingly, it is CMIC's view that the Proposed Rules should not be implemented in Canada until a comprehensive regulatory impact assessment is completed. We submit that this is what the Ontario Regulatory Policy requires.[10] This assessment should include a detailed assessment as to the precise extent to which the Proposed Rules are duplicative, in whole or in part, of existing Canadian law, and a full cost/benefit analysis in consultation with market participants.

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[10] Ontario Regulatory Policy, *supra* note 5 at page 4 under the heading, "Regulatory Impact Assessment".

OTC Derivatives Markets vs Securities Markets: The Notice accompanying the Proposed Rules indicates that NI 31-103 was used as a starting point for the Proposed Rules but that modifications were made to reflect the different nature of derivatives markets. In CMIC's view, the changes made do not go far enough to reflect the fundamental differences between the OTC derivatives markets and securities markets.

An OTC derivatives transaction is a bilateral, privately negotiated transaction where two parties are acting as principal and, generally speaking, both parties have obligations to each other during the term of the transaction which compels good practices. This may be contrasted with a securities transaction where one party offers an investment to a potential investor, the sale of which is effected by an intermediary. The investor does not have any further obligations to the issuer of the security. In the case of securities markets, there is perceived to be an informational imbalance between issuers and investors, which raises the need for protection of the investor by requiring prospectus-level disclosure in public offerings and certain disclosure in private offerings. In OTC derivatives markets, transactions are primarily used by individuals and corporations to hedge risks and accordingly, they are not primarily investment products but risk management products that have substantially different financial profiles, i.e. loss of principal vs. mark-to-market exposure. In addition, in most cases, the perceived informational imbalance that exists in the securities markets is not present in the OTC derivatives markets. Further, in the OTC derivatives markets, transactions are governed by internationally agreed ISDA documentation that, for the most part, is governed by New York law or English law, whereas securities transactions are not. As a result of these fundamental differences between the two markets, it is CMIC's view that some of the concepts in the Proposed Rules which were derived from NI 31-103 are not applicable or appropriate to include in the Proposed Rules. For example, as discussed in greater detail below on pages 16 and 28 three of such provisions are the Fair Terms and Pricing and the Tied Selling provisions, respectively.

In addition, CMIC recommends a three-tiered structure, instead of the proposed two-tiered structure, under which participants in the inter-dealer market would be exempt from all business conduct rules where dealers are transacting with each other. Please see our discussion below in our response to Question 4 on page 13. This three-tiered structure recognizes the differences between the OTC derivatives market and the securities market.

Finally, CMIC submits that the foreign exchange ("**FX**") market in particular should be treated differently than any other OTC derivative asset class given that the FX market is mature and transparent. Further, CMIC notes that over a two year period, FX market participants from 16 jurisdictions around the globe in partnership with 21 central banks representing the largest currency areas have already created a single, global set of best practices principles that are right-sized for the FX market (the "**FX Code of Conduct**")[11]. The FX Code of Conduct is very comprehensive, setting out 55 principles in the areas of ethics, governance, execution, information sharing, risk management and compliance and confirmation and settlement. Accordingly, any regulatory deviation from the FX Code of Conduct would result in market fragmentation. Although the FX Code of Conduct is voluntary, it has been adopted by the industry and received endorsement from the Bank of Canada.[12]

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[11] *FX Global Code*, available at: http://www.globalfxc.org/docs/fx_global.pdf.

[12] The Governors of the Global Economy Meeting (of which the Governor of the Bank of Canada is a member) endorsed the FX Code of Conduct on 25 May 2017. See http://www.bis.org/press/p170525.htm. In addition, the Bank for International Settlements' Report on Adherence to the FX Global Code dated May 2017, tenet 3, required the role of central banks "To lead by example and demonstrate their commitment to promoting and maintaining good market practice. To facilitate this, "central banks will expect that their regular FX trading counterparties adhere to the principles of the FX Code of Conduct, except where this would inhibit the discharge of their legal duties or policy functions". See http://www.bis.org/mktc/fxwg/adherence_report.pdf, pg. 4. Further, at the Canadian Foreign Exchange Committee ("CFEC") Meeting (chaired by the Bank of Canada), it was noted that "The GFXC website (www.globalfxc.org), containing the FX Global

In fact, the Bank of Canada has indicated to a CMIC member that it would discontinue trading with any banks that do not follow the FX Code of Conduct. Therefore, CMIC submits that any derivatives firm following the FX Code of Conduct should be exempt from the Proposed Rules in connection with any FX transaction, whether or not its counterparty is an EDP. In the alternative, CMIC submits that, at a minimum, such exemption should apply in respect of physically-settled FX swaps and FX forwards. Such physically-settled transactions are exempt from the margin requirements under OSFI Guideline E-22[13] and the Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions ("**BCBS-IOSCO**") margin framework for uncleared derivatives[14] and for the same reason such transactions are exempted in such other cases, namely, such transactions amount to simply a contractually required cash payment.

Harmonization: Another fundamental difference between OTC derivatives markets and securities markets is that the OTC derivatives market is global in nature. The overwhelming majority of OTC derivatives transactions entered into by Canadian bank members of CMIC is with a non-Canadian counterparty. In addition, the Canadian OTC derivatives market represents a very small percentage of the global OTC derivatives market, based on notional amount. Therefore, the Canadian OTC derivatives markets are very dependent on global participants. This highlights the importance of having Canadian rules harmonized as much as possible with global rules, as it has been the experience of CMIC members that certain foreign market participants do not find that the benefit of changing and expanding their systems in order to accommodate unique Canadian rules outweigh the costs thereof. Harmonization with global rules, and in particular with the CFTC business conduct rules, which market participants have been complying with for a number of years, is extremely important in order to have a level playing field among market participants regardless of jurisdiction. CMIC submits that any variation from the CFTC business conduct rules will disproportionately increase implementation and compliance costs for global market participants in comparison to the relatively small size of the Canadian OTC derivatives market. This may result in global counterparties exiting the Canadian market, thereby decreasing liquidity and increasing systemic risk.

Timing of Implementation: As the Canadian Securities Administrators ("**CSA**") are aware, the CFTC has commenced a project seeking public input on simplifying and modernizing its rules, including its business conduct rules, and making them less costly to comply with ("**Project KISS**"). Consequently, it is anticipated that the CFTC rules governing OTC derivatives will be reviewed and reassessed, including its business conduct rules, although the details of any changes are not known at this time. In addition, the SEC's business conduct rules for securities based swaps are not yet in force. As the Proposed Rules will also govern securities-based swaps, we may potentially find ourselves in the situation where Canada has imposed business conduct rules with respect to certain counterparties who only transact in securities-based swaps, but such counterparties would not be subject to such business conduct rules if dealing with US counterparties. It is CMIC's view that harmonization of the Proposed Rules to US rules is critically important, and we recommend delaying the implementation of NI 93-101 until the later of the date on which the revised CFTC business conduct rules are in force and the date on which the SEC`s business conduct rules are in force.

**SUBSTITUTED COMPLIANCE**

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Code, the FXWG Report on Adherence to the Global Code, the Statement of Commitment, the request for feedback on last look, the Terms of Reference and membership on the GFXC and other information, will be linked to the CFEC website. As previously discussed at CFEC, signing the Statement of Commitment will in future be a condition for membership of CFEC." See http://www.cfec.ca/files/minutes92.pdf, pg. 2.

[13] OSFI Guideline E-22: *Margin Requirements for Non-Centrally Cleared Derivatives* ("**OSFI Guideline E-22**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e22.aspx.

[14] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, *Margin Requirements for Non-Centrally Cleared Derivatives*, available at: http://www.bis.org/publ/bcbs261.pdf.

It is CMIC's view that substituted compliance should be given under Section 40 to foreign derivatives dealers that are registered as swap dealers under CFTC rules and investment firms that are subject to the requirements of MiFID II[15] on a holistic basis. From an outcomes perspective and taken as a whole, CMIC submits that the business conduct rules under Dodd-Frank and under MiFID II achieve substantially the same objectives as set out under the Proposed Rules. Similarly, it is CMIC's view that substituted compliance should be given on a holistic basis to financial institutions that are regulated by OSFI and subject to OSFI Guideline B-7.[16] As an example, prudential regulators have granted substituted compliance on a holistic basis for uncleared margin requirements notwithstanding there are differences in two sets of rules, given that, taken as a whole, the rules achieve the same outcome.[17] However, the granting of such substituted compliance on a holistic basis should be done in a manner that maintains a level playing field among market participants. In other words, substituted compliance should be given on a holistic basis to both foreign derivatives dealers and Canadian financial institutions, or to neither of them in order to avoid one of them being disadvantaged over the other.

While CMIC strongly urges the CSA to use only an outcomes-based approach, taking into account the entirety of the CFTC and MiFID II rules, as well as OSFI Guideline B-7 and other prudential rules, in the alternative only, CMIC has completed Appendix A of the Proposed Rules for foreign derivatives dealers and Appendix C of the Proposed Rules for Canadian FRFIs showing which specific sections of the Proposed Rules should be given substituted compliance.

Although we may have recommended substituted compliance for certain provisions of the Proposed Rules, we have also recommended their removal in other parts of this letter. Our completion of Appendix A and Appendix C should not detract from any of our arguments below with respect to removal of provisions from the Proposed Rules. In respect of those provisions, the substituted compliance argument and completion of Appendix A and Appendix C should be viewed only as an alternative position.

It is CMIC`s view that the exemption for foreign dealers under Section 40 should not be conditional upon dealing with EDPs. If business conduct rules in a foreign jurisdiction are equivalent, it should not matter that the foreign dealer is not dealing with an EDP. It is also not clear why a derivatives dealer would not qualify for the exemption if it is in the business of trading in derivatives on an exchange or on a derivatives trading facility. Finally, CMIC submits that foreign dealers should not be required to deliver the statement required under Section 40(3)(c) in order to qualify for the exemption. Delivering this statement does not, in CMIC`s view, provide any additional protection to the derivatives party and is something that is generally covered in the applicable derivatives agreement. Accordingly, the costs associated with the increased operational burden outweigh any benefits achieved from the delivery of such a statement. Further, this type of statement is not required by the CFTC as a condition of substituted compliance. This lack of harmonization may further discourage foreign dealers from continuing to trade OTC derivatives with Canadian clients. In the alternative, if this requirement is not removed and the CSA permits foreign firms to rely on substituted compliance when facing non-EDPs, CMIC submits that this statement should only be delivered to non-EDPs, consistent with the requirement under Section 23 of the Proposed Rules. However, please further

[15] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("**MiFID II**"), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065.

[16] OSFI Guideline B7 *Derivatives Sound Practices* ("**OSFI Guideline B-7**"), available at: http://www.osfi-bsif.gc.ca/eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b7_let.aspx.

[17].See Australian Prudential Regulation Authority's Prudential Standard CPS 226, available at http://www.apra.gov.au/CrossIndustry/Consultations/Documents/Final-CPS-226-September-2017.pdf.

note our argument for deleting this requirement altogether on page 29 of this letter. A derivatives dealer that complies with the investor protection requirements under either the Proposed Rules or under a foreign regime deemed equivalent by the CSA will be providing disclosures relevant to all aspects of the relationship. Given this, CMIC's view is that this separate statement provided by foreign dealers to derivatives parties doesn't provide any additional meaningful protection.

**RESPONSES TO QUESTIONS**

**1) Definition of "eligible derivatives party"**

**Q: Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?**

Answer:

Subject to our comments below on page 13 under our response to Question #4 regarding a three-tiered structure, CMIC supports the concept of an EDP to represent sophisticated market participants.

*EDP Definition*
In North America, regulators have formulated two definitions to meet the needs of OTC derivatives markets: the "accredited counterparty" definition in the Derivatives Act (Quebec)[18] and the "eligible contract participant" definition in Dodd-Frank.[19] Market participants in OTC derivatives are comfortable with these definitions and have been using them for a number of years. Both of these definitions inform our comments relating to the proposed EDP definition.

In particular, we note that the business conduct requirements in Sections 63-77 of the Quebec Derivatives Act do not apply to OTC derivatives transactions between accredited counterparties. In other words, market participants who qualify as accredited counterparties are sufficiently sophisticated such that they do not require business conduct protections.[20] We wish to highlight the "accredited counterparty" definition as an effective threshold for the application of business conduct rules in Canadian OTC derivatives markets.

In contrast, we note that the definition of "permitted client" under NI 31-103 was designed for securities markets and is therefore not appropriate for or applicable to OTC derivatives in several areas discussed below.

*Hedger Category*
While the purpose of categorizing counterparties as either an EDP or a non-EDP under the Proposed Rules will determine the extent to which the Proposed Rules will apply to a derivatives dealer's relationship to such counterparty, it is highly likely that the overwhelming majority of large derivatives dealers will only transact with EDPs (just as many large market participants in the OTC derivatives market in Quebec, including Canadian banks, only trade with other accredited counterparties). Accordingly, CMIC submits that it is crucial that the EDP definition be broad enough to include all end-users who currently transact in OTC derivatives transactions for hedging purposes in order to ensure they continue to have the benefit of this key risk management tool.

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[18] *Derivatives Act* (Quebec), c. I-14.01 (the "**Quebec Derivatives Act**"), available at http://legisquebec.gouv.qc.ca/en/ShowDoc/cs/I-14.01

[19] Section 1a(18) of the *Commodity Exchange Act*.

[20] Section 7 of the Quebec Derivatives Act provides that certain sections of the Act, including those relating to registration, business conduct and qualifications, do not apply to activities or transactions in OTC derivatives involving accredited counterparties only.

As noted above, the securities markets are fundamentally different from the OTC derivatives markets, mainly because OTC derivatives transactions are primarily risk management transactions and are entered into by most end-users in order to hedge risks. Accordingly, a hedger category is very useful to small and medium sized businesses, as well as individuals, that do not exceed the thresholds set out in clauses (m) and (n) of the current draft of the definition of EDP. However, such businesses need to hedge their foreign currency or interest rate risks in respect of their commercial operations. For example, a large number of small Canadian companies tend to export goods and services to, or import supplies from, the US as part of their business model. Such companies, regardless of their size, need to routinely hedge their foreign exchange risk. Hedging needs depend on, among other things, the location of a company's customers, its cash flow levels, and interest rate mismatches among its assets and liabilities; it is not correlated to the size of its balance sheet. Under this example, the only possibility for a company to hedge its risks is to maintain access to the OTC derivatives market since such market can provide bespoke products in order to exactly match the size and timing of the company's cash flows. No market other than the OTC derivatives market can provide such a tailored risk management solution. It is telling that both the "accredited counterparty" definition in the Quebec Derivatives Act and the "eligible contract participant" definition in Dodd-Frank include hedger categories.

*Threshold for non-Individuals*

We also wish to mention the fact that the threshold level for non-individuals under clause (m) of the EDP definition is, in CMIC's view, too high. CMIC strongly submits that there should be a lower asset threshold of $10 million. A lower threshold is consistent with the definition of "accredited counterparty" under the Quebec Derivatives Act[21] and with the "eligible contract participant" definition under Dodd-Frank.[22]

*Permitted Client Definition*

As indicated previously, derivatives firms will need to conduct a client outreach in order to ensure that representations received from clients are current and conform to the new requirements under the Proposed Rules. In order to reduce this burden, CMIC recommends that the term, "eligible derivatives party" include as an additional category, all entities that are "permitted clients" under NI 31-103. In CMIC's view, parties qualifying as "permitted clients" in the exempt securities markets are sophisticated enough to be treated as an EDP and therefore do not require the same protection as non-EDPs. Additionally, adding this additional category will allow derivatives firms who already have "permitted counterparty" representations from their counterparties to rely on such representations and eliminate such counterparties from their client outreach efforts.

**Q: Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?**

Answer:

CMIC recommends including individuals with minimum assets of $5 million in the EDP definition, consistent with the "accredited counterparty" definition in the Quebec Derivatives Act.[23] Some may

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[21] This threshold is calculated as "cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than $10,000,000" (*Derivatives Regulation*, c. I-14.01, r.1, s. 1).

[22] $10 million in total assets, or, if hedging a minimum net worth exceeding $1 million

[23] This threshold is calculated as "cash, securities, insurance contracts or deposits having an aggregate realizable value, before taxes, but after deduction of the corresponding liabilities, of more than" $5,000,000 (*Derivatives Regulation*, c. I-14.01, r.1, s. 1). The "eligible contract participant" definition in Dodd-Frank also includes individuals with amounts invested on a discretionary basis, the aggregate of which is in excess of $10 million, or if managing the risk associated with an asset or liability incurred, $5 million.

argue that individuals should not be included as an EDP as there may be some concern that they may not be sophisticated enough, regardless of how many assets they own. Further, some may argue that the amount of a person's total assets is not truly indicative of its sophistication and level of understanding. While that may arguably be the case, a minimum total asset test is also premised on the fact that the individual has the ability to withstand financial losses, has the financial resources to obtain expert advice or otherwise protect themselves through contractual negotiation. In addition, using total assets as an indicator of sophistication is a clear and objective way in which to determine whether an individual is an EDP. Therefore, it is CMIC's view that it is entirely appropriate for individuals with minimum assets of $5 million to be included in the EDP definition. Please note that the threshold recommendations set out in the answers to this Question 1 are to be considered together and not individually.

With respect to individuals, CMIC notes that Section 7(2) of the Proposed Rules requires that a waiver must be obtained by a derivatives firm from an individual that is an EDP if such derivatives firm wishes to be exempt from the provisions set out in Section 7(1)(a)-(d) as they relate to such individual. For the reasons set out in the preceding paragraph with respect to the sophistication and level of understanding of high net worth individuals, CMIC submits that such a waiver is not necessary. In addition, no other current derivatives rule in Canada dealing with the exemption of protections under securities or derivatives legislation requires such a waiver.[24] However, If the CSA continues to require such a waiver, CMIC submits that it should only be given once and the onus for updating such waiver should be placed on the individual in the event the individual wishes to revoke its waiver.

Please also see our comments below on page 24 and 23 where we discuss whether clearing agencies and government entities should be included in the definition of EDP.

**2) Alternative definition of "eligible derivatives party"**

**Q: Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.**

Answer:

No, CMIC submits that it is not appropriate to use the definition of "institutional client" as proposed in CSA Consultation Paper 33-404. As noted above, CMIC believes that regulators should have regard to definitions formulated for the OTC derivatives market, specifically in respect of the thresholds and the inclusion of a hedger exemption. We also note that the "institutional client" definition excludes individuals, while CMIC is supportive of the inclusion of high net worth individuals in the definition of EDP.

***3) Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"***

**Q: If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for**

[24] For example, see: (i) the "qualified party" definition in British Columbia under Blanket Order 91-501 *Over-the-Counter Derivatives*, available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/91-501__BCI_/; (ii) the "qualified party" definition in Alberta under Blanket Order 91-506 *Over-the-Counter Trades in Derivatives*, available at: http://www.albertasecurities.com/Regulatory%20Instruments/4980944%20_%20Blanket_Order_91-506_Over-the-Counter_Trades_in_Derivatives.pdf; and (iii) the "accredited counterparty" definition in Quebec under the Quebec Derivatives Act.

**that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives?**

**Q: Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?**

Answer:

With respect to the knowledge and experience requirement in clauses (m) and (n) of the definition of EDP, CMIC submits that the specific knowledge and experience of the counterparty should not be part of the EDP definition. Instead, it should be sufficient for the determination of a party's status to be based on a "bright line" test, such as the total assets of a party. Having a bright line financial resources test is consistent with the approach taken in other circumstances, for example, with respect to whether a party is an "accredited investor" under NI 45-106[25] and whether a party is a "permitted client" under NI 31-103. In neither of those cases is proficiency assessed and/or attested to as part of the determination as to whether the investor is an "accredited investor" or a "permitted client".

However, if the CSA does not accept CMIC's position as set out in the previous paragraph, it is CMIC's view that the knowledge and experience requirement should apply generally and not to a specific type of transaction. CMIC believes that making this determination on a product-by-product basis would be too granular and this is not something that is done when determining whether an investor is an "accredited investor" or a "permitted client". In addition, it is not practical for derivatives firms to keep track of the status of a counterparty on a product-by-product basis. The status of the counterparty is determined at the beginning of the relationship (or once the Proposed Rules become effective) and will likely be done through written representations. If the status of a counterparty is linked to the knowledge and experience with respect to a specific product, it will be too cumbersome and onerous to keep track of which representations have been received for each product, and then require updated written representations in the event the counterparty decides to enter into any new product. This could lead to these types of counterparties losing access to the OTC derivatives market if it becomes too difficult to implement this requirement. Foreign dealers or advisers in particular may determine that the significant cost of implementing a system specific to Canadian counterparties in order to categorize their EDP status by product type is not worth the benefit of trading with these counterparties. Finally, if the CSA requires this determination on a specific product-by-product basis, the Proposed Rules should describe product types broadly and based only on underlying asset, for example, commodity transactions, interest rate transactions, foreign exchange transactions, credit transactions and equity transactions.

CMIC is also concerned that clauses (m) and (n) of the EDP definition require that written representations must be received from the counterparty. While receiving such representations would be ideal with respect to ensuring that a counterparty qualifies as an EDP, as discussed above, the likelihood of a derivatives dealer receiving all such representations from all counterparties that are required to give them as part of a client outreach is extremely remote. Further, requiring such written representations places an additional burden on clients who are required to make such representations as they may need to engage legal counsel to advise them. CMIC recommends that the wording of these provisions be changed to allow for a derivatives firm to otherwise confirm, acting reasonably, that the counterparty satisfies the financial threshold test, and, if not removed, the knowledge and experience tests.

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[25] National Instrument 45-106 *Prospectus Exemptions* ("**NI 45-106**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy4/PDF/45-106__NI___October_29__2016/.

4) Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties

**Q: Do you agree with the two-tiered approach to investor/customer protection in the Instrument? Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?**

Answer:

Generally speaking, CMIC agrees with the approach that a majority of the Proposed Rules should not apply to an EDP, and CMIC is of the view that there are no additional requirements that a derivatives firm should be subject to when dealing with an EDP. In fact, CMIC submits that the two-tiered approach does not go far enough and recommends that an exemption from the application of the Proposed Rules be given to all derivatives dealers when transacting with another derivatives dealer or with a clearing agency[26] (such exemption, the "**Inter-dealer Exemption**", and such approach is referred to in this letter as a "**three-tiered structure**"). As discussed above, the OTC derivatives market is fundamentally different from the securities market. It is a well-established market that has been functioning without any major issues in Canada. CMIC submits that provisions of the Proposed Rules, such as the "know your client" requirements and the "fair dealing" requirements should not apply to other dealer counterparties. Derivatives dealers have been comfortable transacting with each other under existing prudential rules or other laws (such as anti-money laundering laws and anti-terrorist financing laws) and, in CMIC's view, do not need the added "protection" of the Proposed Rules.

**Q: Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?**

Answer:

In response to this second question, we have described circumstances where the Proposed Rules do not adequately account for current institutional OTC derivatives trading practices when discussing specific sections of the Proposed Rules. For example, in responding to question 7 below with respect to "fair terms and pricing", we describe how such provisions are not appropriate and will place an unreasonable burden on derivatives dealers and unnecessarily discourage trading in OTC derivatives in Canada.

**Q: Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?**

Answer:

With respect to whether the two-tiered approach should apply to a derivatives adviser that is advising an EDP, it is CMIC's view that it should. Section 7(3) of the Proposed Rules currently provides that the two-tiered approach would not apply where a portfolio manager is making decisions in respect of a managed account on behalf of an EDP such that the portfolio manager would need to comply with all of the requirements under the Proposed Rules. CMIC submits that such an approach is not warranted.

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[26] See further discussion of clearing agencies on page 17 of this letter.

The portfolio manager has fiduciary obligations to each underlying EDP. In addition, the parties are sophisticated market participants and EDPs have sufficient financial resources to both purchase professional advice and to protect themselves through contractual negotiation with the portfolio manager. Indeed, the parties would typically enter into an investment management (or similar) agreement that clearly sets out the contractually negotiated terms in respect of the managed account arrangement. In CMIC's view, the underlying EDPs should not be treated like non-EDPs simply because they have chosen to purchase professional advice via a managed account arrangement. It is unclear why an EDP that is not in a managed account relationship which has the financial resources to purchase professional advice but chooses not to when transacting with a dealer directly (which is not uncommon) is deemed not to require the extra protections afforded by the Proposed Rules, and yet an underlying EDP that enters into a contractually negotiated agreement in a managed account situation does. The significant compliance costs associated with the inclusion of Section 7(3) are not, in our view, proportionate to the benefits.

If the CSA does not agree with the above approach, CMIC recommends, as an alternative position only , that (i) the EDP should be given the option of electing out of some or all of the protections given to non-EDPs under the two-tiered structure, or (ii) if a managed account is for an EDP that is a regulated entity, such as a pension plan, Section 7(3) would not apply in such circumstances.

### 5) Business trigger guidance

**Q: Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?**

Answer:

CMIC submits that the business trigger guidance is one of the most important aspects of the Proposed Rules as this will clarify whether a party will be subject to the business conduct obligations. The definition of "derivatives dealer" and the Companion Policy refer to a person or company being in scope under the Proposed Rules if they are in the business of "trading" derivatives. In CMIC's view, this reference to "trading" should be deleted and replaced with the word "dealing", which is a more accurate reflection of what a derivative dealer does.

The Companion Policy also refers to the fact that a person or company that meets the definition of "derivatives adviser" or "derivatives dealer" in a local jurisdiction is subject to the instrument in that jurisdiction. We assume this means that the counterparty of such person or company is physically located in a local jurisdiction at the time a trade is negotiated or executed and the Proposed Rules would apply only to counterparties in such local jurisdiction. In other words, the jurisdiction of incorporation or head office or principal place of business of such counterparty is not relevant to the analysis of whether the derivatives dealer is "in a local jurisdiction". We further assume that the obligations under these business conduct rules do not apply when a derivatives firm faces a counterparty that is not located in Canada. Imposing these conduct requirements on a Canadian firm transacting with a counterparty located in a foreign jurisdiction would place that Canadian firm at a competitive disadvantage relative to other firms operating in that jurisdiction, and would require them to obtain Canadian specific KYDP information and documentation in relation to a foreign counterparty's EDP status which the counterparty would not have to provide to other non-Canadian firms. We submit that regulators in each foreign jurisdiction are best positioned to determine the business conduct rules that are required to protect counterparties located in their jurisdiction. Finally, we also assume that the activities of a person or company in one jurisdiction should not affect the characterization of its activities in another jurisdiction. For example, a US company registered as a US swap dealer is clearly in the business of dealing in derivatives in the US. However, if the only OTC derivatives transactions it enters into in Canada are with a Canadian bank for purposes of

hedging its Canadian dollar exposure, CMIC submits that such US swap dealer would not be a "derivatives dealer" in Canada. CMIC strongly recommends that these three jurisdictional points are expressly clarified in the Companion Policy.

In terms of the substantive guidance provided in the Companion Policy, it is CMIC's view that the guidance does not appropriately or clearly describe the circumstances where a person or company would be considered a derivatives dealer or derivatives adviser. First and foremost, the only way in which a person or company can be a "derivatives dealer" is if it is in the business of dealing in derivatives, or holding itself out as dealing in derivatives. In CMIC's view, this means that such person or company makes a two-way market in OTC derivatives or routinely quotes prices at which they would be willing to transact. That is the only way in which a person or company can be a "derivatives dealer" and this fact should be highlighted in the Companion Policy. All the other factors listed in the Companion Policy, other than entering into transactions frequently, are simply factors to be considered which may evidence that a person or company makes a market in OTC derivatives. With respect to the frequency of entering into transactions, it is CMIC's view that the frequency of transactions is irrelevant to whether a person or company is making a market in OTC derivatives, and should be removed from this guidance. Frequent or regular hedging or speculative transactions may be undertaken by a corporate end-user, but in CMIC's view, that activity should not mean that such corporation is a derivatives dealer, even if it profits from such speculative transactions.

### 6) Fair Dealing

**Q: Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?**

Answer:

CMIC members are very committed to fair dealing as a matter of culture and reputational risk and bank members of CMIC are also subject to existing laws and regulatory rules that mandate fair dealing. In addition, member banks have a record of commitment to managing their affairs and dealing with their counterparties in a fair manner. As discussed below, there is already a framework in place that covers the fair dealing obligation and it is working well. Further, there have been no appreciable or material examples of banks or other derivatives firms in Canada violating existing fair dealing rules. CMIC submits that this is an example of how the need for regulation of this particular issue has not been clearly identified and yet rules are being proposed to address a perceived need, contrary to the principles under the Ontario Regulatory Policy. The current framework relies on OSFI Guideline B-7, public interest powers (for example, Section 127 of the Ontario Securities Act[27]) and statutory powers of securities regulators to deal with fraud and with misleading or untrue statements in connection with derivatives transactions (for example, Sections 126.1 and 126.2 under the Ontario Securities Act). In addition to statutory law, common law recognizes the general organizing principle of good faith and honest performance under contracts.[28]

The introduction of an express statutory duty to act "fairly" could give rise to negative unintended consequences. The derivatives dealer/counterparty relationship is not a fiduciary relationship in the normal course nor do duties of good faith apply to the negotiation of transactions at common law (although, as noted above, they do apply to some extent to the exercise of contractual discretionary

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[27] *Securities Act* (Ontario), R.S.O. 1990, c. S.5 (the "**Ontario Securities Act**"), available at: https://www.ontario.ca/laws/statute/90s05.

[28] See *Bhasin v. Hrynew*, 2014 SCC 71 ("**Bhasin**"), available at: https://scc-csc.lexum.com/scc-csc/scc-csc/en/item/14438/index.do. In Bhasin, the Supreme Court of Canada recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result of Bhasin, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest performance, which cannot be excluded by the terms of an agreement.

rights as a result of the Bhasin case). CMIC submits that having a flexible fair dealing model that changes depending upon the sophistication of a counterparty and the context creates transactional uncertainty.

In the alternative, if the CSA does not agree that the fair dealing provisions should be deleted, CMIC submits that Section 8 of the Proposed Rules should be harmonized with Dodd-Frank. Under Dodd-Frank, a swap dealer must communicate in a fair and balanced manner based on principles of fair dealing and good faith.[29] Further, Dodd-Frank does not place a statutory obligation on the individual acting on behalf of a derivatives firm, which, in our view, is the correct approach. Placing liability on the individual is, in CMIC's view, overly broad and not consistent with the approach taken by the CFTC or in Europe under MiFID II. Accordingly, CMIC submits that Section 8 should be harmonized with Dodd-Frank but at a minimum, Section 8(2) of the Proposed Rules should be deleted.

With respect to the requirement in Section 8(3) of the Proposed Rules, CMIC submits that allocating transaction opportunities fairly among derivatives parties by derivatives advisers is not an applicable concept in the OTC derivatives markets. Most transactions are bespoke for a particular derivatives party and is not something that would or should be allocated to another derivatives party. Accordingly, in CMIC's view, Section 8(3) of the Proposed Rules should be deleted.

### 7) Fair terms and pricing

**Q: Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?**

Answer:

In CMIC's view, the fair terms and pricing provision under Section 19 of the Proposed Rules is not appropriate in the context of the OTC derivatives market. Since these are privately negotiated, bilateral, bespoke transactions, there is no simple quick way to price all the components of a trade. Therefore, there is no "fair" price in the traditional meaning of the term. The "fair" price will be whatever is agreed upon between the two parties, bearing in mind the competitive nature of the industry. The end-user counterparty is actually, usually, in the best position to determine the best price for a transaction since it has the ability to solicit quotes from other derivatives dealers. Variations in prices quoted by different dealers could simply mean that a dealer's internal costs, including liquidity costs, capital charges and related hedging costs, are higher or lower and may be affected by market volatility, so it is not the case that they are not quoting a "fair price".

It should be noted (and perhaps, quite telling) that there is no comparable provision included under the CFTC rules nor under MIFID II. For this reason, and the reasons stated in the previous paragraph, it is CMIC's view that Section 19 should be deleted. It is not clear what is meant by "fair terms" in the context of OTC derivatives. This aspect of the Proposed Rules creates a new cause of action that is inappropriate in the competitive derivatives market and fails to recognize that existing remedies are available where there has been inappropriate conduct by way of fraud or misrepresentation. These types of existing legal remedies are operating properly to regulate activity and ensure proper allocation of risk. Creating such a new cause of action would disrupt the existing allocation of legal and operational risk and does so in a manner that does not respond to any existing problem. In fact, CMIC submits that imposing a duty to provide a "fair" price will have the unintended consequence of opening the door to significant unnecessary litigation where, in hindsight, the outcome of the trade was not as the counterparty expected (or hoped) it would be. We are dealing with, in the main, a wholesale market between sophisticated parties.

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[29] See 17 CFR Part 23, s. 23.433.

### 8) Derivatives Party Assets

**Q: National Instrument 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party. Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?**

Answer:

As currently drafted, it is CMIC's view that Division 2 of Part 4 should not apply in respect of an EDP, except with respect to Section 24 of the Proposed Rules. If a derivatives firm is subject to the requirements under NI 94-102[30] (and complies with, or is exempt from, those requirements), it should not be required to comply with the terms of Division 2 of Part 4.

However, in CMIC's view, it is not appropriate to include provisions relating to how "derivatives party assets" are held, used or invested in an OTC derivatives business conduct rule. The only time that a derivatives dealer, acting as principal, will be "holding" derivatives party assets is if the assets constitute margin[31] under the terms of the particular OTC derivatives transaction (or under a master agreement governing such transaction). This is different than client assets held by a securities dealer, since those assets may include securities held by the securities dealer for safekeeping, in addition to margin.

For OTC derivatives transactions, CMIC submits that Division 2 of Part 4 should be re-written to clearly indicate that a derivatives dealer may re-hypothecate margin received from its counterparty as long as such counterparty consents to such re-hypothecation, or the dealer is otherwise permitted to re-hypothecate pursuant to the terms of an applicable margin agreement. This ability to re-hypothecate would be subject to any segregation requirements under other rules or regulations governing OTC derivatives transactions, such as NI 94-102 in the context of cleared transactions, OSFI Guideline E-22, the provincial margin rules for uncleared transactions (once published), and any other specific rule or regulation governing a specific type of counterparty, such as NI 81-102[32]. If the CSA were to restrict this right to re-hypothecate, it would have significant pricing and liquidity implications for market participants as the majority of OTC derivatives transactions are priced assuming this right to rehypothecate will be available (subject to the above-referenced margin rules). This right to re-hypothecate with consent is consistent with European rules under MiFID II[33] and with CFTC rules.[34] If the Proposed Rules were to be re-written in such manner, it is CMIC's view that Division 2 of Part 4 would apply whether or not the counterparty is an EDP.

As noted in the previous paragraph, CMIC is of the view that Division 2 of Part 4 should only deal with the ability to re-hypothecate a counterparty's assets delivered to the derivatives dealer as margin. If the counterparty and the derivatives dealer bilaterally agree to segregate such margin, they can also

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[30] National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* ("**NI 94-102**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/94-102__NI___July_4__2017/.

[31] The term "margin" is deemed to also include a reference to "collateral" and includes property transferred under an absolute transfer credit support agreement, as the context requires.

[32] National Instrument 81-102 *Investment Funds* ("**NI 81-102**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy8/PDF/81-102__NI___March_8__2017/.

[33] See MiFID II, a. 16(8).

[34] See 17 CFR Part 23, s. 23.701. A customer has the right to require that a swap dealer segregate initial margin. This right does not extend to variation margin. There are no other restrictions on a swap dealer's right to re-hypothecate if it has its counterparty's consent.

agree to any restrictions relating to the use or investment of such margin. While there are investment restrictions under NI 94-102 and under E-22, those rules are primarily concerned with systemic risk. CMIC submits that it is unnecessary for the business conduct rules to deal with such issues which can be adequately addressed by way of contract. This is another example of how the need for regulation of this particular issue has not been clearly identified, resulting in a solution being presented under the Proposed Rules for an unidentified problem, contrary to one of the principles under the Ontario Regulatory Policy.[35]

It is not clear why the Proposed Rules use the broadly defined term "derivatives party assets" rather than "margin" in Sections 26-28, which would be more in line with the approach taken in Part 2 of NI 94-102. At a minimum, CMIC submits that the qualification "relating to derivatives transactions" should be incorporated into the definition itself as the definition is too broad and could include assets unrelated to the derivatives transaction. It is also not clear how Sections 26-28 of the Proposed Rules are intended to apply to the activities of a portfolio manager acting on behalf of a managed account, where discretionary authority has been contractually granted to the adviser in respect of the use and investment of a portfolio of assets that involves more than but includes the use of derivatives. It would be helpful if this could be explained.

9) Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. **Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?**

Answer:

It is CMIC's view that Sections 21, 22 and 30 of the Proposed Rules should align with the CFTC rules under Dodd-Frank. The CFTC rules provide that a swap dealer is required to disclose to its counterparty the "methodology and assumptions" used to prepare the daily mark and any material changes during the term of the swap, provided that the swap dealer is not required to disclose to the counterparty any confidential or proprietary information about any model it may use to prepare the daily mark.[36] It is unclear whether "inputs and assumptions" would be equivalent to "methodology and assumptions", but arguably, "inputs" implies that more specific information will be required to be provided as opposed to only the "methodology" as required under the CFTC rules. CMIC recommends that the approach taken by the CSA under the Proposed Rules be aligned with the CFTC rules on this point, so as to achieve a harmonized result.

**10) Senior derivatives managers**

**Section 33 of the Instrument imposes certain supervisory, management, and reporting obligations on "senior derivatives managers", and section 34 imposes related duties on the firm to respond to reports of non-compliance, and in certain circumstances to report non-compliance to the regulator or securities regulatory authority.**

**Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.**

Answer:

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[35] See the discussion of the Regulatory Policy on page 2.

[36] See 17 CFR Part 23, s. 23.431(d).

Compliance is a top priority for CMIC members, including ensuring that the right persons within the organization are monitoring and enforcing compliance matters and that responsibility for compliance matters is properly and clearly allocated. CMIC members are very focused on ensuring a "culture of compliance". There is robust existing regulatory guidance on establishing effective compliance regimes in Canada, and Canadian institutions are internationally well regarded in this regard.

With respect to CMIC member firms that are FRFIs, the RCM Guideline[37] provides that the Chief Compliance Officer ("**CCO**") should be responsible for assessing the adequacy of, adherence to and effectiveness of the FRFI day-to-day controls, and for providing an opinion to the board whether, based on the independent monitoring and testing conducted, the Regulatory Compliance Management ("**RCM**") controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide. Furthermore, OSFI Guideline E-21[38] clearly outlines the "three lines of defence" approach to compliance as the recommended approach:

> *"FRFIs should ensure effective accountability for operational risk management. A "three lines of defence" approach, or appropriately robust structure, should serve to delineate the key practices of operational risk management and provide adequate objective overview and challenge. How this is operationalized in practice in terms of the organisational structure of a FRFI will depend on its business model and risk profile."*

Specifically, the "three lines of defence" is stated by OSFI to be:

> First Line of Defence
>
> The business line – the first line of defence – has ownership of risk whereby it acknowledges and manages the operational risk that it incurs in conducting its activities. The first line of defence is responsible for planning, directing and controlling the day-to-day operations of a significant activity/enterprise-wide process and for identifying and managing the inherent operational risks in products, activities, processes and systems for which it is accountable.
>
> Second Line of Defence
>
> The second line of defence is the oversight activity that objectively identifies, measures, monitors and reports operational risk on an enterprise basis. It consists of a collection of operational risk management activities and processes, including the design and implementation of the FRFI's framework for operational risk management. The second line of defence is best placed to provide specialized reviews related to the FRFI's operational risk management. In addition, it should be noted that other staff/corporate areas of the FRFI (e.g. compliance) may also be deemed part of the second line of defence.
>
> A key function required of the second line of defence is to provide an objective assessment of the business lines' inputs to and outputs from the FRFI's risk management (including risk measurement/estimation), and to establish reporting tools to provide reasonable assurance that they are adequately complete and well-informed.
>
> Third Line of Defence

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[37] OSFI Guideline E-13 *Regulatory Compliance Management* (the "**RCM Guideline**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e13_let_2014.aspx.

[38] OSFI Guideline E-21 *Operational Risk Management* ("**OSFI Guideline E-21**"), available at: http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/e21.aspx .

> The internal audit function is charged with the third line of defence. The third line of defence should be separate from both the first and second lines of defence, and provide an objective review and testing of the FRFI's operational risk management controls, processes, systems and of the effectiveness of the first and second line of defence functions. The third line of defence is best placed to observe and review operational risk management more generally within the context of the FRFI's overall risk management and corporate governance functions. Objective review and testing coverage should be sufficient in scope to verify that the operational risk management framework has been implemented as intended and is functioning effectively.

The requirements proposed under Sections 33 and 34 of the Proposed Rules differ significantly from existing best practices. The proposed regime is at odds with the existing compliance regime structure, as the existing regime is focused on the key role of the CCO as having ultimate responsibility for oversight of monitoring and reporting on compliance matters, and is premised on the CCO being independent from the lines of business. Practically speaking, the definition of "senior derivatives manager" at the desk level would result in a significant number of individuals who are principally responsible for managing one or more derivatives business desks at a large derivatives firm. This makes it extremely difficult to provide consistent oversight and reporting for all business lines and would result in oversight fragmentation. The current regime does not have that result.

There is, in the view of CMIC members and as reflected in existing regulatory guidance, an inherent conflict of interest in having a senior manager attest to compliance within his or her business line. While first-line business units are responsible for complying with applicable laws and regulations, the second-line compliance group performs the independent monitoring and reporting function. Compliance is best achieved by having a person outside of the business unit, such as the CCO, having ultimate responsibility for oversight of monitoring and reporting on compliance matters, as reflected in the "three lines of defence" approach to compliance.

The proposed regime also requires senior managers to submit a report to the Board of Directors. It is not, in the view of CMIC, appropriate for senior managers to interact with the Board of Directors at this level, given the number of persons in this role and their potentially conflicting and limited viewpoints. Requiring trading desk-level compliance and reporting is, in the view of CMIC, too granular to be effective.

In fact, it is CMIC's strongly-held view that the proposed senior manager compliance regime in the Proposed Rules would create a serious risk of not being able to ascertain who is responsible for oversight of monitoring and reporting on compliance matters. This is the risk that both regulators and legislators in both the UK and Hong Kong were seeking to address but which is not present under existing Canadian rules and regulations.

Finally, the proposed requirements create a unique element to Board compliance reporting as derivatives businesses are required to certify compliance directly. The infrastructure to support that unique form of certification globally will require significant change to current processes.

*International Regimes*

The compliance and risk management function under NI 93-101 is imposed upon senior derivatives managers, being the business persons responsible for different business units; under CFTC rules, by contrast, compliance is overseen by a chief compliance officer, and risk management is overseen by a risk management unit, all of which would be consistent with OSFI's approach as seen in its RCM Guideline.

Under NI 93-101, senior derivatives managers are responsible for supervision, for promoting compliance and for remedying non-compliance within their business unit, and are required to report to the board of directors on such compliance matters at least once per year; by comparison, CFTC rules require the appointment of a compliance officer that oversees compliance matters, and that is responsible for reporting to the board of directors or other senior officers at least once per year.

While the U.K. Financial Conduct Authority's Senior Managers and Certification (SM&CR) regime (the "**UK Regime**") and the Hong Kong Securities and Futures Commission's Measures for Augmenting the Accountability of Senior Management (the "**HK Regime**") also impose obligations on senior derivatives managers, they originate from a very different context.

The UK Regime was put in place as a result of recommendations made by the Parliamentary Commission on Banking Standards ("**PCBS**") in 2013, aiming to improve standards in financial services following the LIBOR crisis. The PCBS found that lack of individual accountability contributed to the LIBOR crisis.[39]

> "One of the most dismal features of the banking industry to emerge from our evidence was the striking limitation on the sense of personal responsibility and accountability of the leaders within the industry for the widespread failings and abuses over which they presided. Ignorance was offered as the main excuse. It was not always accidental. Those who should have been exercising supervisory or leadership roles benefited from an accountability firewall between themselves and individual misconduct, and demonstrated poor, perhaps deliberately poor, understanding of the front line. Senior executives were aware that they would not be punished for what they could not see and promptly donned the blindfolds. Where they could not claim ignorance, they fell back on the claim that everyone was party to a decision, so that no individual could be held squarely to blame—the Murder on the Orient Express defence. It is imperative that in future senior executives in banks have an incentive to know what is happening on their watch—not an incentive to remain ignorant in case the regulator comes calling."

Accordingly, the PCBS recommended changes to ensure additional individual responsibility:

> "The Commission recommends that the Approved Persons Regime be replaced by a Senior Persons Regime. The new Senior Persons Regime must ensure that the key responsibilities within banks are assigned to specific individuals who are aware of those responsibilities and have formally accepted them. The purposes of this change are: first, to encourage greater clarity of responsibilities and improved corporate governance within banks; second, to establish beyond doubt individual responsibility in order to provide a sound basis for the regulators to impose remedial requirements or take enforcement action where serious problems occur. This would not preclude decision-making by board or committee, which will remain appropriate in many circumstances. Nor should it prevent the delegation of tasks in relation to responsibilities. However, it would reflect the reality that responsibility that is too thinly diffused can be too readily disowned: a buck that does not stop with an individual stops nowhere."[40]

The context of the UK regime therefore differs significantly from the Canadian context, where there has not been any such crisis of confidence in financial firm culture and governance.

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[39] Parliamentary Commission on Banking Standards, "Changing banking for good", available at https://www.publications.parliament.uk/pa/jt201314/jtselect/jtpcbs/27/2704.htm.

[40] *Ibid.*

Another rationale that underlies the UK Regime is the lack of clarity that existed as to responsibility for compliance matters prior to the enactment of the regime, as noted numerous times by the PCBS in its report:

> "723. Banks have a set of obligations that are externally imposed, through general law and specifically through regulatory requirements. These must be adhered to by everyone in the bank. In addition to the mandatory legal obligations, banks set their own control standards, relating to their overall business strategy, that they also need to ensure are being adhered to. The responsibility for making sure that there are no breaches of any of the internally or externally imposed requirements lies with all who work in the bank. **The evidence suggests that the role of compliance is hopelessly confused.**"[41] [our emphasis]

The UK approach to compliance accordingly appears not to have been well developed, clear and prescriptive prior to the enactment of the UK Regime. In contrast, the existing Canadian regime under the RCM Guideline and OSFI Guideline E-21 delineates clear and detailed responsibility and duties.

Similarly, the HK Regime also originated from a different context.

> "The key concern that appears to be driving this new initiative is that the SFC doesn't always know which individuals are responsible for key decisions, many of which may be taken by executives based outside Hong Kong. The circular quotes Principle 9 of the SFC's existing Code of Conduct, which states that the senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. In determining where responsibility lies, and the degree of responsibility of a particular individual, regard shall be had to that individual's apparent or actual authority in relation to the particular business operations….
>
> In other words, "*unless we know who to the point the finger at we can't do our job as regulator as effectively as we need to.*" "[42]

As is the case for the UK Regime, the context of the HK Regime differs from the Canadian context, as decision-makers in Canadian firms are typically located in Canada, unlike Hong Kong. Furthermore, in Canada, compliance responsibility is clearly ascribed so there is no similar concern that it is difficult to identify where the responsibility lies, pursuant to the RCM Guideline and OSFI Guideline E-21, including the "three lines of defence" approach.

Australia has recently proposed a banking executive accountability regime in order to strengthen the accountability of senior executives and directors in the banking industry. The responsibility for implementing this regime lies with the Australian Prudential Regulatory Authority (APRA), and focuses only on the prudential aspect, and not on the market conduct aspect, of management accountability. It therefore appears that this accountability regime will, if implemented, largely follow the OSFI approach as opposed to the senior derivatives manager approach under the Proposed Rules.

### 11) Exemptions

**Q: Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.**

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[41] *Ibid.*

[42] Francis Kean, Willis Towers Watson, "Hong Kong to introduce new "Senior Managers Regime", available at http://blog.willis.com/2017/01/hong-kong-to-introduce-new-senior-managers-regime/.

Answer:

See our discussion under the heading, "Substituted Compliance" on page 7, as well as the completed Appendix A and Appendix C (attached as Schedules A and B, respectively, to this letter) which set out the relevant sections of the Proposed Rules for which CMIC recommends that substituted compliance should be granted, along with the corresponding foreign law and domestic law, as applicable.[43] CMIC will not be providing commentary with respect to the exemptions under Section 41 (Investment Dealers) and Section 44 (Foreign Derivatives Advisers) under the Proposed Rules.

**ADDITIONAL COMMENTS**

Quebec Derivatives Act

CMIC is concerned that Sections 63-77 of the Quebec Derivatives Act and the Proposed Rules impose duplicative business conduct requirements on dealers and advisers in respect of OTC derivatives transactions that are not between accredited counterparties. We note that the Proposed Rules do not provide for any mechanism to achieve substituted compliance in respect of the Quebec Derivatives Act (other than for Canadian financial institutions, which typically trade OTC derivatives with only accredited counterparties).

In respect of OTC derivatives transactions between accredited counterparties, CMIC is concerned that the Proposed Rules may impose business conduct requirements notwithstanding that Section 7 of the Quebec Derivatives Act clearly exempts those same transactions from the equivalent business conduct requirements in the Quebec Derivatives Act. For example, if a Canadian bank is transacting with an accredited counterparty that is not an EDP, Section 11 of the Proposed Rules would impose suitability requirements even though Section 7 of the Quebec Derivatives Act exempts suitability requirements set out in Section 65 of the Quebec Derivatives Act. CMIC believes that the Proposed Rules are inconsistent with the Quebec Derivatives Act insofar as the Proposed Rules impose obligations that are equivalent to those expressly exempted by Section 7 of the Quebec Derivatives Act.[44]

Exclusion for Government Entities, etc.:

CMIC requests that the CSA clarify the scope of the exclusion for government entities contemplated under Section 6 of the Proposed Rules. In CMIC's view, it is unclear from the drafting of Section 6 whether it would have the effect of (i) excluding persons from complying with the obligations under the Proposed Rules whenever such persons are transacting with government entities, central banks and international organizations, (ii) excluding government entities, central banks and international organizations from complying with the obligations under the Proposed Rules, or (iii) both (i) and (ii). CMIC notes that there are several government entities listed under paragraphs (g) and (h) of the EDP definition under Section 1 of the Proposed Rules, and accordingly, it would appear that persons that are transacting with government entities would be required to comply with at least some of the obligations under the Proposed Rules. This means that Section 6 excludes government entities, central banks and international organizations only from complying with the obligations under the Proposed Rules and does not exempt derivatives firms from such obligations when facing government entities, central banks and international organizations. This interpretation is consistent with CFTC rules where swap dealers are required to comply with the obligations under the CFTC rules when transacting with government entities, which are referred to as "special entities" under the

[43] See also the draft Guideline issued by OSFI for Derivatives Sound Practices for Federally Regulated Private Pension Plans.

[44] Section 5(2) of the *Regulations Act* (Quebec) c. R-18.1 requires a proposed regulation to be in harmony with existing acts and regulations.

CFTC rules. It is CMIC's view that this interpretation should be confirmed and clarified in the Companion Policy.

In addition, CMIC submits that the entities contemplated under the Section 6 exclusion should be expanded to include (i) an express reference to national, federal, state, provincial, territorial or municipal government of or in any foreign jurisdiction or any agency of that government, consistent with paragraph (h) of the EDP definition; and (ii) any Crown corporation, agency or any other entity which is wholly-owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities. To be consistent, CMIC further submits that paragraph (g) of the EDP definition should be amended to replace the phrase, "wholly-owned entity of the Government of Canada or a jurisdiction of Canada" with "any other entity which is wholly-owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities".

Exclusion for Clearing Agencies:

In the same vein, CMIC requests that the CSA provide clarification on the scope of the exclusion for clearing agencies contemplated under Section 5 of the Proposed Rules. The wording of Section 5 is similar to Section 6, which simply provides that "this instrument does not apply" to a regulated clearing agency. As discussed above, we have concluded that such wording in Section 6 means that government entities, central banks and international organizations are exempt from complying with the obligations as a derivatives firm under the Proposed Rules, but it does not exempt derivatives firms who face them from the obligations under the Proposed Rules. Accordingly, derivatives firms facing regulated clearing agencies would be required to comply with the obligations under the Proposed Rules, however, regulated clearing agencies are not listed as an EDP. It is possible that they are excluded from the EDP definition because the CSA intends that the *beta* and *gamma* transactions in cleared derivatives (i.e. pursuant to which the original *alpha* transaction between the counterparties is novated to the clearing agency) be excluded from the Proposed Rules, based on the definition of "derivatives dealer" referring to a person engaged in the business of "trading" in derivatives ("trading" is defined[45] to exclude the novation of a derivative with a clearing agency). CMIC believes that such transactions should be excluded given that they are governed by rules and procedures that create a comprehensive framework imposed by clearing agencies, which are therefore not in need of any protection under the Proposed Rules. This should be clarified particularly in light of the above recommendation on page 14 to change the term "trading" to "dealing". Also, clearing agencies enter into proprietary trades that are not cleared transactions. In those circumstances, CMIC believes that clearing agencies should be included within the EDP definition, and thus persons transacting with clearing agencies in uncleared transactions should only be required to comply with the basic obligations that apply to transactions with all counterparties, and should not be required to comply with the more extensive obligations that apply to transactions with unsophisticated counterparties.

Suitability:

CMIC appreciates the importance of suitability obligations in promoting counterparty protection and maintaining a fair and equitable marketplace, but believes that the scope of the suitability obligations contemplated under Section 12 is too wide, particularly insofar as these obligations require that derivatives firms assess suitability in respect of instructions received from counterparties, and not just recommendations made to counterparties. CMIC notes that the requirement to assess suitability in respect of instructions is inconsistent with the suitability requirements under the CFTC rules, which only require swap dealers to assess suitability in respect of recommendations. More specifically, under the CFTC rules, a swap dealer is required to have a reasonable basis for believing that any

[45] See the Ontario Securities Act, s. 1.

swap or trading strategy that it recommends to a counterparty is suitable for that counterparty[46], but is not required to have a reasonable basis for believing that a particular swap or trading strategy that it has been instructed to enter into is suitable for that counterparty. In addition, under MiFID II[47], suitability obligations are limited to advisory or portfolio management activities, where the investment firm has the obligation to warn the client that the product or service is not appropriate. CMIC submits that it is inappropriate to require derivatives firms to second guess the instructions of their counterparties by performing an additional suitability analysis. CMIC is concerned that such an additional suitability analysis may cause delays in execution and increased costs for counterparties, and may have a negative impact on liquidity in the Canadian derivatives marketplace. Accordingly, CMIC suggests that the requirement to assess suitability in respect of instructions should be eliminated from the Proposed Rules.

CMIC also believes that the suitability obligations under Section 12 are overly broad insofar as these obligations apply to transactions with counterparties who, while not EDPs, nevertheless have demonstrated a level of sophistication, and have made representations that they are capable of independently evaluating a particular derivatives transaction. CMIC notes that under the CFTC rules, a swap dealer will be deemed to satisfy its suitability obligations if, among other things, (i) it determines that the counterparty, or an agent to which the counterparty has delegated decision-making authority, is capable of independently evaluating risks with regard to the relevant swap or trading strategy involving a swap, and (ii) the counterparty or its agent represents in writing that it is exercising independent judgment in evaluating the recommendations of the swap dealer.[48] CMIC is of the view that a similar safe harbour should be included under the Proposed Rules. CMIC submits that the inclusion of such a safe harbour will have the effect of lowering the cost of compliance associated with the suitability obligations contemplated under the Proposed Rules, by reducing the amount of counterparty-specific due diligence that must be undertaken in support of suitability determinations.

CMIC also recommends that an exemption be available from both the information requirement in Section 11 and the suitability requirement in Section 12 for transactions where a counterparty does not know the identity of its counterparty prior to the execution of a transaction. This may arise with block trades, where an adviser transacts on behalf of managed accounts but the dealer does not know which of the adviser's accounts will be allocated to the trade. This may also arise on a venue such as a swap execution facility ("**SEF**") or designated contract market ("**DCM**") where a dealer may not be able to assess suitability due to the anonymous nature of the trade execution.

In addition, CMIC recommends providing relief from suitability requirements to mirror the CFTC's relief in NAL 13-70[49] in respect of swaps that are intended to be cleared ("**ITBC Swaps**"). As rationale for its relief in NAL 13-70, the CFTC noted: (i) the impossibility or impracticality of compliance when the identity of the counterparty is not known prior to execution, (ii) the likelihood that swaps initiated anonymously on a SEF will be standardized and therefore the information about material risks and characteristics of such swaps is likely to be available from the SEF or other wisely available source, (iii) the fact that following clearing, the swap dealer and its counterparty have no further obligations to each other, so there is no on-going relationship that would be governed by trading relationship documentation, and (iv) relief from these requirements provide an incentive to transact on SEFs and to clear swaps, both major policy goals of Dodd-Frank. CMIC submits that this rationale is equally persuasive and relevant in the Canadian context.

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[46] See 17 CFR Part 23, s. 23.434(a).

[47] See MiFID II, a. 25(2) and 25(3).

[48] See 17 CFR Part 23, s. 23.434(b).

[49] CFTC Letter No. 13-70 *No-Action Relief: Swaps Intended to be Cleared* ("**NAL 13-70**"), available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-70.pdf.

Finally, CMIC submits that the suitability obligations under the Proposed Rules should be revised to clarify that suitability is not required to be assessed by a derivatives firm on a transaction-by-transaction basis. In practice, suitability determinations are only made at the time of on-boarding clients and at the time of a material change in circumstances of a client, as it is too burdensome to conduct the due diligence in support of suitability determinations on a transaction-by-transaction basis and may result in delays in processing trades. Accordingly, CMIC believes that derivatives firms should be able to satisfy their suitability obligations by making a suitability determination at the outset of their relationship with a particular derivatives party and thereafter only whenever there has been a material change in circumstances of the derivatives party, and not on a transaction-by-transaction basis. To the extent that suitability determinations may be satisfied by representations from counterparties who are non-EDPs, as CMIC has argued for above, then CMIC anticipates that such representations would be included in relationship documentation that is entered into at the time of on-boarding clients.

Know-your-derivatives party ("**KYDP**"):

CMIC notes that the KYDP information collection requirements under the Proposed Rules are more prescriptive than those under the CFTC rules, and require derivatives firms to collect a variety of KYDP information that may not be required under the CFTC rules. In particular, the Proposed Rules require a derivatives firm to collect information on whether a derivatives party is an insider of a public company or otherwise has access to material non-public information, the identity of any individual who is a beneficial owner of its voting securities (in the case of a corporation) and who exercises control over its affairs (in the case of partnership or trust), which information is not specifically required under the CFTC rules. CMIC notes that it will be operationally burdensome for derivatives firms to begin collecting information from counterparties that they are not already collecting under the CFTC rules. In the interest of reducing compliance costs and promoting efficiency and harmonization, CMIC submits that the CSA should eliminate any KYDP information collection requirements that are inconsistent with the comparable requirements under the CFTC rules, including those identified above.

CMIC also notes that KYDP information collection requirements under the CFTC rules only apply where the identity of a counterparty is known to the swap dealer prior to execution of the transaction, which may be true with respect to derivatives transactions that are executed on a DCM or SEF or in respect of block trades.[50] There is no comparable exemption from the KYDP information collection requirements under the Proposed Rules. Plainly, a derivatives firm will not be able to comply with the KYDP information collection requirements under Sections 10 and 11 of the Proposed Rules in circumstances where it does not know the identity of its counterparty, and accordingly, CMIC requests that the CSA incorporate a comparable exemption into the Proposed Rules.

In addition, CMIC recommends providing relief from KYDP requirements to mirror the CFTC's relief in NAL 13-70 in respect of ITBC Swaps. In addition to the CFTC's rationale discussed above on page 25, we note that dealers typically do not onboard SEF ITBC Swap counterparties due to CFTC guidance that if the swap fails to clear it should be void *ab initio*[51] which mitigates the need for KYDP documentation.

Finally, CMIC acknowledges the inclusion of an exemption[52] from the KYDP information collection requirements for only registered firms and regulated financial institutions. However, CMIC suggests that this exemption be extended to all derivatives firms transacting with or advising EDPs and to derivatives dealers transacting with clients that are not EDPs acting through portfolio managers.

[50] See 17 CFR Part 23, s. 23.402(b).

[51] CFTC Staff Guidance on Swaps Straight-Through Processing dated September 26, 2013, available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/stpguidance.pdf

[52] See the Proposed Rules, s. 5.

CMIC expects that the majority of EDPs in the Canadian derivatives marketplace will be large, well established entities, and that information on such entities will be readily available in the public domain. With respect to clients that are not EDPs acting through portfolio managers, derivatives dealers should be able to rely upon the extensive KYDP procedures undertaken by portfolio managers, who will often have a closer relationship with the client.

Conflicts of Interest:

CMIC notes that there is considerable overlap between the conflicts of interest requirements contemplated under the Proposed Rules and the conflicts of interest requirements under existing Canadian laws, including both prudential laws and securities laws. Under the Bank Act[53], for example, Canadian banks are required to establish procedures to identify and address conflicts of interest. More specifically, in the derivatives context, OSFI Guideline B-7 requires federally regulated financial institutions that are dealing in derivatives to take reasonable steps to identify and address potential material conflicts of interest. Although the conflicts of interest requirements under these and other existing Canadian laws may be framed in slightly different terms from those contemplated under the Proposed Rules, CMIC is of the view that they are substantively similar and achieve the same objectives. Since market participants are already subject to conflicts of interest requirements under existing prudential and securities laws, CMIC submits that the conflicts of interest requirements under the Proposed Rules are redundant and unnecessary, and suggests that they be eliminated from the Proposed Rules.

To the extent that the CSA determines that it is necessary to include additional conflicts of interest requirements under the Proposed Rules, CMIC requests that the CSA provide further guidance on the types of conflicts of interest that a derivatives firm would be required to manage under the Proposed Rules, as CMIC believes that the wording of Section 9 and the related commentary in the companion policy is insufficiently precise in identifying such conflicts. In its present form, Section 9 suggests that a derivatives firm may be required to manage a full range of conflicts, both actual and potential, in connection with all of its different business activities. This represents a considerable departure from the conflicts of interest rules under the CFTC rules, where swap dealers are generally only required to manage particular conflicts of interest relating to research and clearing activities. More specifically, the CFTC rules include requirements around the separation of research and clearing units from trading units, and place restrictions on the activities taken within and among these units, but do not otherwise require swap dealers to manage conflicts of interest with respect to other business units.[54] If the CSA determines that it is necessary to include conflicts of interest requirements in the Proposed Rules, then CMIC is of the view that the CSA should harmonize its position with the CFTC, and that these rules should only require derivatives firms to manage conflicts of interest relating to research and clearing activities.

We further submit that an exemption is necessary where the identity of a counterparty is not known to a dealer and where it may not be possible to ascertain certain conflicts of interest that arise in respect of the identity of the counterparty.

Referral Arrangements:

CMIC submits that it is inappropriate to impose broad referral arrangement obligations as contemplated under the Proposed Rules, and notes that there are no comparable obligations under the CFTC rules, other than very limited requirements with respect to referral arrangements involving special entities. Since there are no comparable obligations under the CFTC rules, CMIC expects that foreign derivatives dealers that are complying with the CFTC rules would not be eligible for

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[53] *Bank Act* (Canada), S.C. 1991, c. 46 (the "**Bank Act**"), available at: http://laws-lois.justice.gc.ca/eng/acts/B-1.01/.

[54] See 17 CFR Part 23, s. 23.605.

substituted compliance in respect of these obligations. Without the availability of substituted compliance, CMIC is concerned that many foreign derivatives dealers may be deterred from participating in the Canadian derivatives marketplace, which could have a negative impact on liquidity. Accordingly, CMIC submits that the referral arrangement obligations under the Proposed Rules should be eliminated. At a minimum, it is CMIC`s view that there should be an exception for inter-group referrals.

Complaint Handling:

CMIC believes that derivatives firms are already incentivized to manage (and indeed, do manage) complaints from derivatives parties in an appropriate manner, in order to preserve their relationships with such derivatives parties. In some cases, this may be done by way of a written response, but in other cases, a written response may be unnecessary or inappropriate. As well, CMIC submits that it is inappropriate to include complaint handling obligations under the Proposed Rules, as these obligations are not included in the CFTC rules. Although the CFTC rules do include a requirement for swap dealers to maintain records of complaints[55], they do not otherwise include any requirements around how complaints are to be handled. Accordingly, CMIC does not believe that an obligation to handle complaints in any particular manner should be codified in the Proposed Rules. As noted above, if the CSA includes such an obligation in the Proposed Rules, CMIC expects that foreign derivatives dealers would not be entitled to substituted compliance in respect of such obligation, which may be an additional reason that could deter foreign derivatives dealers from participating in the Canadian derivatives marketplace.

Tied Selling:

The tied selling rules are duplicative of existing rules found in Canadian legislation. For example, there are provisions under the Bank Act[56] which provide that a bank may not impose undue pressure on, or coerce, a person to obtain a product or service from a particular person as a condition for obtaining another product or service from the bank. Similarly, the *Unfair or Deceptive Acts or Practices Regulation* under the *Insurance Act* (Ontario) provides that no person shall engage in any unfair or deceptive act or practice, which is defined to include making the issuance or variation of a policy of automobile insurance conditional on the insured having or purchasing another insurance policy. CMIC also believes that it is inappropriate to impose a prohibition on tied selling under the Proposed Rules, which again, does not have an analogue under the CFTC rules nor under MiFID II. Accordingly, since there are existing regulations dealing with tied selling, along with the fact that there are no tied selling provisions under the CFTC rules nor MiFID II, CMIC submits that the tied selling provisions should be deleted from the Proposed Rules.

Disclosure to Derivatives Parties:

CMIC appreciates the importance of disclosure obligations in increasing transparency and reducing the informational asymmetries between derivatives firms and derivatives parties. As noted at the outset of this letter, however, CMIC believes that the disclosure requirements under the Proposed Rules should be harmonized with the disclosure requirements under the CFTC rules to the greatest degree possible, as it will be operationally burdensome and costly for derivatives dealers to begin implementing new disclosure processes that have not already been implemented in connection with the CFTC rules.

With that principle in mind, CMIC notes that there are several mandatory disclosure requirements contemplated under the Proposed Rules that are inconsistent with the mandatory disclosure

[55] See 17 CFR Part 23, s. 23.201(b).
[56] See the Bank Act, s. 459.1.

requirements under the CFTC rules. By way of example, CMIC notes that the following disclosure obligations do not appear to have an analogue under the CFTC rules: (i) the obligation to disclose the risks of using borrowed money or leverage in a written statement delivered to a derivatives party prior to a transaction, (ii) the obligation for a foreign derivatives dealer to provide a notice to a derivatives party of the legal risks of dealing with a party located in a foreign jurisdiction, and (iii) the obligation for a derivatives firm to provide general relationship information including, for example, information on its business and products, information on the compensation paid to its employees, and information on any conflicts of interest that may exist between the derivatives firm and the derivatives party. With respect to each of these items, CMIC has not been able to identify comparable disclosure obligations under the CFTC rules. Derivatives firms would therefore be required to implement new disclosure processes in order to comply with these additional disclosure obligations. CMIC submits that the benefits provided by these particular disclosure obligations would be outweighed by the costs of implementing these disclosure obligations, and accordingly, suggests that they be removed from the Proposed Rules.

With respect to pre-transaction disclosure, CMIC recognizes that the pre-transaction disclosure requirements under the Proposed Rules, which require a derivatives firm to disclose information about the material characteristics and risks of a derivatives transaction, are largely consistent with the pre-transaction disclosure requirements under the CFTC rules. However, CMIC notes that under the CFTC rules, there is an exemption from the pre-transaction disclosure requirements for transactions that are executed on a SEF or a DCM, and where it is impossible to determine the identity of the counterparty prior to the transaction.[57] There are no comparable exemptions included under the Proposed Rules. As a result, derivatives firms may be placed in the untenable position of being required to disclose certain transactional information to a derivatives party whose identity is unknown to the derivatives firm at the time of entering into the transaction. As this is clearly an unworkable standard, CMIC requests that the CSA incorporate exemptions from the pre-transaction disclosure obligations that parallel those exemptions that are included under the CFTC rules. In addition, CMIC recommends providing relief from disclosure requirements to mirror the CFTC's relief in NAL 13-70 in respect of ITBC Swaps.

Notice by Non-resident Derivatives Firms

As noted previously under the last paragraph of the Substituted Compliance discussion on page 8, it is CMIC`s view that the notice requirement for non-resident derivatives firms under Section 23 is not necessary and should be deleted. CMIC submits that the information that is required to be provided under Section 20 would sufficiently cover the information set out under Section 23 since Section 20 requires that a derivatives firm must deliver all information that a reasonable person would consider important. Further, with respect to the name and address of the agent for services, this is standard information provided in relationship documentation.[58]

Reporting to Derivatives Parties:

As noted above, CMIC appreciates the importance of reporting obligations in increasing transparency and reducing informational asymmetries, but believes that it is necessary to harmonize the reporting requirements under the Proposed Rules with those under the CFTC rules wherever possible, in order to increase efficiencies and reduce costs.

*Valuations*

[57] See 17 CFR Part 23, s. 23.431(c).

[58] See Part 4 of the standard Schedule to an ISDA master agreement.

With respect to the requirement to provide valuations, CMIC notes that both the Proposed Rules and the CFTC rules require a dealer to provide a counterparty with a daily mark, but the Proposed Rules require a daily mark be provided in a broader range of transactions. In particular, the Proposed Rules appear to contemplate that derivatives firms will make available daily marks for both cleared and uncleared transactions, whereas the CFTC rules only require swap dealers to provide daily marks for uncleared transactions.[59] This is a substantial difference. CMIC notes that for transactions that are cleared through a clearing agency, derivatives parties will already have access to valuation information from the clearing agency. As such, CMIC submits that the requirement for a derivatives firm to make additional valuation information available to a derivatives party is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by any attendant benefits. Accordingly, CMIC is of the view that the requirement for derivatives firms to make available daily marks under the Proposed Rules should be harmonized with the requirement for swap dealers to make available daily mid-market marks under the CFTC rules, and that daily marks should only be required for uncleared transactions. In addition, CMIC submits that the Proposed Rules should allow counterparties to be given the option of not being provided with this daily valuation as it may be the case that certain counterparties are not interested in receiving that information. In such circumstances, the derivatives firm should not be required to make that information available to those counterparties.

*Trade Confirmations*

Similarly, although both the Proposed Rules and the CFTC rules require a dealer to provide a counterparty with a post-trade confirmation, there are differences in the content of the trade confirmations under these two regimes by virtue of their level of prescription. The Proposed Rules include a number of requirements for the content of trade confirmations that are not included in the CFTC rules. For example, the Proposed Rules require trade confirmations to include information on the nature of the derivatives dealer's involvement in the transaction (i.e. whether it is transacting as principal or agent), the commissions or sales charges levied by the derivatives firm, and the name of the individual acting on behalf of the derivatives firm, none of which are identified as necessary contents under the CFTC rules. CMIC notes that to the extent that derivatives dealers are required to include information in trade confirmations that are delivered pursuant to the Proposed Rules that is not required to be included in trade confirmations that are delivered pursuant to the CFTC rules, then derivatives dealers may be required to prepare different trade confirmations for different jurisdictions, and may need to engage in the costly exercise of re-configuring their reporting systems to account for these differences. Moreover, although CMIC expects that many of the prescribed contents under the Proposed Rules would generally be included in trade confirmations, there may be circumstances where it does not make sense for a derivatives firm to include this type of information in a particular trade confirmation, for example, because of the nature of the asset that is being transacted. Accordingly, CMIC believes that the CSA should be less prescriptive with respect to the contents of trade confirmations, and should not specify any particular required contents.

*Transactions executed on derivatives trading facilities; cleared transactions*

As well as differences in the content of trade confirmations under the Proposed Rules and the CFTC rules, there are also differences in the availability thereof, as a result of exemptions from the trade confirmation requirements under the CFTC rules. That is, under the CFTC rules, swap dealers are not required to deliver trade confirmations for transactions that are executed on a SEF or DCM and for transactions that are submitted for clearing by a DCO, as such transaction confirmations will be separately prepared and delivered by the SEF, DCM or DCO, as applicable.[60] There is no comparable exemption under the Proposed Rules. In the absence of such an exemption, derivatives

[59] See 17 CFR Part 23, s. 23.431(d).
[60] See 17 CFR Part 23, s. 23.501(a)(4).

dealers will be required to prepare and deliver transaction confirmations to derivatives parties, notwithstanding that derivatives parties will already be receiving such transaction confirmations from a derivatives trading facility or a clearing agency and that the derivatives dealer may not know the identity of its counterparty. As with the requirement to provide a daily mark for cleared swaps, CMIC submits that this requirement is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by any potential benefits that may result from having a second transaction confirmation. Accordingly, CMIC submits that the Proposed Rules should be revised to include an exemption from the requirement to deliver trade confirmations for transactions that are executed on a derivatives trading facility or for transactions that are submitted for clearing.

*Monthly Statements*

In addition to daily marks and trade confirmations, the Proposed Rules also contemplate that derivatives firms will provide derivatives parties with monthly statements addressing, among other things, recent derivatives transactions, current derivatives positions, a description of derivatives party assets held by the derivatives firm and account balances. CMIC notes that there is no comparable requirement to provide monthly statements under the CFTC rules. In addition, CMIC notes that while there is a requirement to provide periodic reports under MiFID II, these periodic reports are only provided on a quarterly basis, and moreover, are only delivered where an investment firm is providing portfolio management services.[61] As there are no requirements to prepare monthly statements under either the CFTC rules or MiFID II, it will be necessary for derivatives dealers to implement new reporting technology to facilitate the preparation and delivery of the monthly statements contemplated under the Proposed Rules. This will be operationally burdensome and costly for derivatives dealers. Moreover, CMIC anticipates that many derivatives parties do not wish to receive monthly statements. Accordingly, CMIC is of the view that the requirement for derivatives firms to deliver monthly statements should be eliminated.

Record-keeping:

CMIC notes that the CSA has already introduced extensive record-keeping requirements under MI 96-101[62] and the equivalent regulations in the Provinces of Manitoba, Ontario and Quebec (collectively, the "**TR Rule**"). CMIC submits that the requirement for derivatives firms to maintain records under the Proposed Rules that are comparable to those maintained under the TR Rule is redundant and unnecessary, and that the costs associated with implementing this requirement would be outweighed by identified benefits. Accordingly, CMIC submits that the record-keeping requirements under the Proposed Rules should be eliminated, and that derivatives firms should only be subject to record-keeping requirements in accordance with the TR Rule.

In the context of derivatives firms that are federally regulated financial institutions, CMIC notes that the record-keeping requirements under the Proposed Rules are also duplicative of record keeping requirements under prudential regulations. For example, under the RCM Guideline, OSFI expects a federally regulated financial institution's regulatory compliance management framework to include ''Adequate Documentation'' as one of its key controls. Likewise, pursuant to OSFI Guideline B-7, each federally regulated financial institution is required to have mechanisms in place to assure the confirmation, maintenance, and safeguarding of derivatives contract documentation. As noted above, CMIC believes that the record-keeping requirements under the Proposed Rules are redundant and should be eliminated in their entirety. However, if the CSA believes that additional record-keeping requirements in the Proposed Rules are necessary, then CMIC submits that federally regulated

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[61] See the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016, a. 60(1).

[62] Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* ("**MI 96-101**"), available at: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/96-101__MI___July_28__2016/.

financial institutions should be exempt from compliance with such record-keeping requirements, similar to the exemption for compliance with the KYDP information collection requirements (which are similarly covered under existing Canadian laws and regulations). In the alternative, CMIC believes that federally regulated financial institutions should be granted substituted compliance with respect to the record-keeping requirements, pursuant to Section 42 of the Proposed Rules.

With respect to the written agreement requirement under Section 35 of the Proposed Rules, CMIC notes that both the Proposed Rules and the CFTC rules require derivatives firms to enter into written agreements with derivatives parties detailing the material terms of their relationships and describing their respective rights and obligations. CMIC acknowledges that the prescribed contents of these written agreements, which includes payment terms, netting terms, event of default terms, valuation terms and dispute resolution terms, are substantively similar under both the Proposed Rules and the CFTC rules. However, CMIC is concerned that the written agreement obligations under the Proposed Rules may be broader than those under the CFTC rules, insofar as they require derivatives parties to enter into written agreements for certain transactions that would not require a written agreement under the CFTC rules. In particular, the CFTC rules include an exemption from the written agreement requirement for transactions that are executed on a DCM or anonymously on a SEF, and for transactions that are cleared by a DCO.[63] There are no comparable exemptions for these transactions under the Proposed Rules. As noted above, it is obvious that a derivatives firm will not be able to enter into a written agreement with a derivatives party whose identity is unknown to the derivatives firm, and accordingly, CMIC submits that a comparable exemption should be included under NI 93-101.

Similarly, under the CFTC rules, swap dealers may satisfy the written agreement requirement in respect of certain FX transactions by way of a deemed ISDA pursuant to the DF Protocol. CMIC notes that it is unlikely that derivatives firms in Canada will be able to enter into a comparable protocol providing for deemed ISDAs, in light of the small size of the Canadian derivatives market. As a result, derivatives firms may be required to enter into written agreements when engaging in FX transactions in Canada, but may not be required to enter into such agreements when engaging in FX transactions in the U.S. In order to avoid this regulatory gap, CMIC believes that it would be appropriate for the CSA to include an exemption from the written agreement requirement for FX transactions, which would align with current market practice. As noted at the outset of this letter, FX markets are mature and transparent, and because foreign exchange products are frequently used as hedging products, it may be less important for derivatives firms and derivatives parties to enter into written agreements in connection with such transactions.

CMIC submits that the use of both the terms “derivatives” and “transactions” under the recordkeeping requirement in Section 36 is confusing. The term, “transaction” is defined as being limited to derivatives. Therefore, CMIC recommends that the following changes should be made to Section 36:

- the phrase “derivatives, transactions” in the lead-in language of Section 36 should be amended to remove the comma that appears between the two words; and
- the phrase “for each derivative” that appears at the beginning of Sections 36(b) and (c) should be replaced with “for each transaction”.

Further, CMIC submits that Sections 36(d)(vii) and (viii) should be deleted as these items relate to systemic risk and not business conduct. Recordkeeping in respect of netting of derivatives and margining and collateralization is already addressed under applicable margin rules.

[63] See 17 CFR Part 23, s. 23.504(a)(ii).

CMIC notes that Section 37 of the Proposed Rules provides that a derivatives firm must keep a record for a period of 7 years following the date on which the derivatives party`s last derivative expires or is terminated, except in the case of Manitoba, which requires this period be 8 years. CMIC submits that this time period should be harmonized amongst all jurisdictions in Canada.

End-user Exemption:

CMIC requests that the CSA revise the end-user exemption under Section 39 to clarify the scope of this exemption. CMIC notes that as presently drafted, the concept of an end-user is essentially framed in opposite terms from the concept of a derivatives firm. CMIC submits that this formulation of the concept of an end-user is vague and imprecise. Rather, CMIC is of the view that end-users should be defined by reference to particular categories of persons that should be considered end-users. Under the MiFID II regime, for example, CMIC notes that certain categories of persons, including pension funds, insurance and reinsurance companies and collective investment undertakings, are excluded from the scope of the business conduct rules under MiFID II.[64] CMIC believes that a comparable approach should be adopted under the Proposed Rules, and that all of these categories of persons should be exempt from the business conduct obligations under the Proposed Rules, on the basis that these categories of persons are end-users and are not commercial providers of derivatives products.

Effective Date:

CMIC submits that the effective date of the Proposed Rules should incorporate a one year transition period, commencing on the date the Proposed Rules come into force. This will allow derivatives firms sufficient time to implement any procedural and systems changes, including conducting a client outreach, before they are required to comply with the final rules.

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**CONCLUSION**

As you will have seen, CMIC has provided its comments and recommendations on the Proposed Rules within the four themes of (i) duplication of the Proposed Rules (for example, fair dealing, KYDP and substituted compliance recommendations), (ii) harmonization with global rules (for example, suitability, referral obligations and tied selling recommendations), (iii) fundamental differences between the OTC derivatives markets and securities markets (for example, inter-dealer exemption, FX Transaction exemption, derivatives party assets and fair terms and pricing recommendations) and (iv) the timing of implementation (effective date recommendation). CMIC also re-iterates its very strong recommendation that a second, full comment period be afforded to market participants on the Proposed Rules, concurrently with a second, full comment period on Registration Rules so that they can both be analyzed together in order to determine their full effect on market participants and the Canadian OTC derivatives markets.

CMIC welcomes the opportunity to discuss this response with you. The views expressed in this letter are the views of the following members of CMIC:

Alberta Investment Management Corporation
Bank of America Merrill Lynch
Bank of Montreal
Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce

[64] See MiFID II, a. 2(1).

Citigroup Global Markets Inc.
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Invesco Canada Ltd.
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
Morgan Stanley
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Public Sector Pension Investment Board
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank

**SCHEDULE A TO**
**CMIC RESPONSE LETTER TO PROPOSED NI 93-101**
(see attached)

**APPENDIX A**
**TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT***

**FOREIGN DERIVATIVES DEALERS**
**(Section 40)**

**LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO FOREIGN DERIVATIVES DEALERS**

| Foreign Jurisdiction | Laws, Regulations or Instruments | Provisions of this Instrument applicable to a foreign derivatives dealer despite compliance with the foreign jurisdiction's laws, regulations or instruments |
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| United States | Section 24.433 of Code of Federal Regulations, Title 17, Part 23 *Swap Dealers and Major Swap Participants* ("**17 CFR Part 23**") – Communications – fair dealing<br><br>Section 23.410 of 17 CFR Part 23 – Prohibition on fraud, manipulation, and other abusive practices | Section 8 – Fair dealing |
| United States | Section 23.605 of 17 CFR Part 23 – Conflicts of interest policies and procedures | Section 9 – Conflicts of interest |
| United States | Section 23.402 of 17 CFR Part 23 – General provisions | Section 10 – Know your derivatives party |
| United States | Section 23.434 of 17 CFR Part 23 – Recommendations to counterparties – institutional suitability | Section 11 – Derivatives-party-specific needs and objectives<br><br>Section 12 – Suitability |
| United States | Section 23.504 of 17 CFR Part 23 – Swap trading relationship documentation | Section 20 – Relationship disclosure information |
| United States | Section 23.321 of 17 CFR Part 23 – Disclosures of material information | Section 21 – Pre-transaction disclosure |
| United States | Section 23.321(d) of 17 CFR Part 23 – Disclosures of material information – Daily mark | Section 22 – Daily reporting |
| United States | Section 23.701 of 17 CFR Part 23 – | Section 25 – Segregating derivatives |

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| | Notification of right to segregation<br><br>Section 23.702 of 17 CFR Part 23 – Requirements for segregated margin<br><br>Section 23.704 of 17 CFR Part 23 Investment of segregated margin<br><br>Section 23.704 of 17 CFR Part 23 Requirements for non-segregated margin | party assets<br><br>Section 26 – Holding derivatives party assets<br><br>Section 27 – Use of derivatives party assets<br><br>Section 28 – Investment of derivatives party assets |
| United States | Section 23.501 of 17 CFR Part 23 – Swap confirmation | Section 29 – Content and delivery of transaction confirmations |
| United States | Section 23.201 of 17 CFR Part 23 – Required records<br><br>Section 23.202 of 17 CFR Part 23 – Daily trading records<br><br>Section 23.203 of 17 CFR Part 23 – Records; retention and inspection | Section 36 – Records<br><br>Section 37 – Form, accessibility and retention of records |
| European Union | Article 24 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 (the "**MiFID II Directive**") – General principles and information to clients<br><br>Article 28 of MiFID II Directive – Client order handling rules | Section 8 – Fair dealing |
| European Union | Article 16 of MiFID II Directive – Organisational requirements<br><br>Article 23 of MiFID II Directive – Conflicts of interest<br><br>Article 33 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 (the "**MiFID II Delegated Regulation**") – Conflicts of interest potentially detrimental to a client<br><br>Article 34 of MiFID II Delegated Regulation – Conflicts of interest policy<br><br>Article 35 of MiFID II Delegated | Section 9 – Conflicts of interest |

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| | Regulation – Record of services or activities giving rise to a detrimental conflict of interest<br><br>Article 36 of MiFID II Delegated Regulation – Investment research and marketing communications<br><br>Article 37 of MiFID II Delegated Regulation – Additional organisational requirements in relation to investment research or marketing communications<br><br>Article 38 of MiFID II Delegated Regulation – Additional general requirements in relation to underwriting or placing<br><br>Article 39 of MiFID II Delegated Regulation – Additional requirements in relation to pricing of offerings in relation to issuance of financial instruments<br><br>Article 40 of MiFID II Delegated Regulation – Additional requirements in relation to placing<br><br>Article 41 of MiFID II Delegated Regulation – Additional requirements in relation to advice, distribution and self placement<br><br>Article 42 of MiFID II Delegated Regulation – Additional requirements in relation to lending or provision of credit in the context of underwriting or placement<br><br>Article 43 of MiFID II Delegated Regulation – Record keeping in relation to underwriting or placing | |
| European Union | Article 25 of MiFID II Directive – Assessment of suitability and appropriateness and reporting to clients<br><br>Article 54 of MiFID II Delegated Regulation – Assessment of suitability | Section 11 – Derivatives-party-specific needs and objectives<br><br>Section 12 – Suitability |

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| | and suitability reports<br><br>Article 55 of MiFID II Delegated Regulation – Provisions common to the assessment of suitability and appropriateness<br><br>Article 56 of MiFID II Delegated Regulation – Assessment of appropriateness and related record-keeping obligations | |
| European Union | Article 24 of MiFID II Directive – General principles and information to clients<br><br>Article 11 of Commission Delegated Directive (EU) 2017/593 of 7 April 2016 (the “**MiFID II Delegated Directive**”)<br><br>Article 12 of MiFID II Delegated Directive – Inducements in respect of investment advice on an independent basis or portfolio management services<br><br>Article 13 of MiFID II Delegated Directive – Inducements in relation to research | Section 13 – Permitted referral arrangements<br><br>Section 14 – Verifying the qualifications of the person or company receiving the referral<br><br>Section 15 – Disclosing referral arrangements to a derivatives party |
| European Union | Article 26 of MiFID II Delegated Regulation – Complaints handling | Section 17 – Handling complaints |
| European Union | Article 27 of MiFID II Directive – Obligation to execute orders on terms most favourable to the client<br><br>Article 64 of MiFID II Delegated Regulation – Best execution criteria<br><br>Article 65 of MiFID II Delegated Regulation – Duty of investment firms carrying out portfolio management and reception and transmission of orders to act in the best interests of the client<br><br>Article 66 of MiFID II Delegated Regulation – Execution policy | Section 19 – Fair terms and pricing |

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| European Union | Article 25 of MiFID II Directive – Assessment of suitability and appropriateness and reporting to clients<br><br>Article 58 of MiFID II Delegated Regulation – Retail and Professional Client agreements | Section 20 – Relationship disclosure information |
| European Union | Article 48 of MiFID II Delegated Regulation – Information about financial instruments | Section 21 – Pre-transaction disclosure |
| European Union | Article 9 of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 ("**EMIR**") | Section 22 – Daily reporting |
| European Union | Article 16 of MiFID II Directive – Organisational requirements<br><br>Article 2 of MiFID II Delegated Directive – Safeguarding of client financial instruments and funds<br><br>Article 3 of MiFID II Delegated Directive – Depositing of client financial instruments<br><br>Article 4 of MiFID II Delegated Directive – Depositing client funds<br><br>Article 5 of MiFID II Delegated Directive – Use of client financial instruments<br><br>Article 6 of MiFID II Delegated Directive – Inappropriate use of title transfer collateral arrangements<br><br>Article 7 of MiFID II Delegated Directive – Governance arrangements concerning the safeguarding of client assets<br><br>Article 8 of MiFID II Delegated Directive – Reports by external auditors | Section 25 – Segregating derivatives party assets<br><br>Section 26 – Holding derivatives party assets<br><br>Section 27 – Use of derivatives party assets<br><br>Section 28 – Investment of derivatives party assets |
| European Union | Article 59 of MiFID II Delegated Regulation – Reporting obligations in | Section 29 – Content and delivery of |

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| | respect of execution of orders other than for portfolio management | transaction confirmations |
| European Union | Article 16 of MiFID II Directive – Organisational requirements<br><br>Article 72 of MiFID II Delegated Regulation – Retention of records<br><br>Article 73 of MiFID II Delegated Regulation – Record keeping of rights and obligations of the investment firm and the client<br><br>Article 74 of MiFID II Delegated Regulation – Record keeping of client orders and decision to deal<br><br>Article 75 of MiFID II Delegated Regulation – Record keeping of transactions and order processing<br><br>Article 76 of MiFID II Delegated Regulation – Recording of telephone conversations or electronic communications | Section 36 – Records<br><br>Section 37 – Form, accessibility and retention of records |

**SCHEDULE B TO**
**CMIC RESPONSE LETTER TO PROPOSED NI 93-101**

(see attached)

**APPENDIX C**
**TO NATIONAL INSTRUMENT 93-101 *DERIVATIVES: BUSINESS CONDUCT***

**CANADIAN FINANCIAL INSTITUTIONS**
**(Section 42)**

**LAWS, REGULATIONS OR INSTRUMENTS APPLICABLE TO CANADIAN FINANCIAL INSTITUTIONS**

| Federal or provincial prudential regulator or other applicable regulator | Laws, Regulations or Instruments | Provisions of this Instrument applicable to a Canadian Financial Institution despite compliance with applicable federal or provincial regulatory requirements | Commentary |
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| Office of the Superintendent of Financial Institutions (“OSFI”)/ Securities commissions/ Competition Bureau | OSFI Guideline B-7 *Derivatives Sound Practices*<br><br>*Securities Act* (Ontario), s. 126.1, 127<br><br>*Bhasin v. Hrynew*, 2014 SCC 71<br><br>*Competition Act,* Part VII.1 | Fair Dealing – s. 8(1), 8(2), 8(3) | OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a federally regulated financial institution (“**FRFI**”) should act honestly and in good faith when marketing, negotiating, entering into, executing and administering transactions with its clients or counterparties. Staff who are involved in trading or providing advice in relation to derivatives trades should have the appropriate education, skills, experience and training to carry out their responsibilities.<br><br>Ontario securities regulators also have broad public interest powers under Section 127 of the Ontario *Securities Act* (the “OSA”). In addition, separate from the public interest powers, the OSA also deals with fraud and with misleading or untrue statements.<br><br>More generally, the Supreme Court of Canada in *Bhasin v. Hrynew* recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result |

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| | | | of *Bhasin*, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest performance, which cannot be excluded by the terms of an agreement. These obligations apply only to the corporate counterparty, because of privity of contract, and not to individuals acting on behalf of the corporate counterparty. The exception to this would be an independent tort that would arise if the individual acted fraudulently.<br><br>In addition, certain deceptive marketing practices are criminal offences or reviewable matters under the *Competition Act*, including false and misleading representations to the public (which can include misrepresentations to businesses). |
| OSFI | *Bank Act,* s. 157(2)(b), 157(2)(c), 459.1(1), 459.1(4.1)<br><br>*Insurance Companies Act,* s. 165(2)(b), 165(2)(c), 489<br><br>OSFI *Supervisory Framework*<br><br>OSFI Guideline B-7 *Derivatives Sound Practices* | Conflicts of interest – s. 9(1), 9(2), 9(3) | Pursuant to Section 157(2)(c) of the *Bank Act*, the directors of the bank must establish procedures to resolve conflicts of interest, including techniques for the identification of potential conflict situations and for restricting the use of confidential information.<br><br>Pursuant to Section 157(2)(b) of the Bank, the directors of a bank must establish a review committee to ensure compliance with the self-dealing provisions of the *Bank Act*, while 157(2)(d) requires that banks designate a committee of the board of directors to monitor the conflict of interest procedures.<br><br>Section 459.1(1) of the *Bank Act* prohibits a bank from imposing undue pressure on, or coercing a person to obtain a product or service from a particular person, including the bank and any of its affiliates, as a condition for obtaining another product or |

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| | | | service from the bank. Section 459.1(4.1) requires a bank to disclose coercive tied selling arrangements.<br><br>Equivalent requirements apply to federally regulated insurance companies (s. 165(2)(b), 165(2)(c), 489 *Insurance Companies Act*) under the equivalent legislation.<br><br>In addition, OSFI's *Supervisory Framework* requires monitoring of conflicts of interest through a bank's risk management program.<br><br>More specifically, in the derivatives context, OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a FRFI dealing in derivatives should take reasonable steps to identify and address potential material conflicts of interest. |
| OSFI/ Financial Transactions and Reports Analysis Centre of Canada ("FINTRAC") | *Proceeds of Crime (Money Laundering) Terrorist Financing Act* and associated regulations<br><br>FINTRAC guidelines<br><br>OSFI Guideline B-8 *Deterring and Detecting Money Laundering and Terrorist Financing* | Know your client (KYC) – s. 10(2), 10(3), 10(4), 10(5) | The *Proceeds of Crime (Money Laundering) Terrorist Financing Act* and associated regulations and guidelines as well as OSFI Guideline B-8 *Deterring and Detecting Money Laundering and Terrorist Financing* have extensive requirements relating to KYC and in particular require FRFIs to establish an anti-money laundering program, including written policies and procedures, and to identify the identity of its clients. In particular, in the case of a client that is an entity, FRFIs must in particular take reasonable measures to obtain the names, addresses and occupations of individuals who are the ultimate beneficial owners of 25% or more of the entity. |
| OSFI | OSFI Guideline B-7 *Derivatives Sound Practices* | Suitability – s. 11, 12(1), 12(2) | OSFI Guideline B-7 *Derivatives Sound Practices*, provides that FRFIs are expected to take necessary steps to mitigate legal |

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| | | | risk, including, prior to engaging in derivatives transactions. |
| N/A | *Criminal Code* s. 426 | Referrals – s. 13, 14, 15(1) | Pursuant to Section 426 of the *Criminal Code*, it is an offence to (a) directly or indirectly, corruptly gives, offers or agrees to give or offer to an agent or to anyone for the benefit of the agent — or, being an agent, directly or indirectly, corruptly demands, accepts or offers or agrees to accept from any person, for themselves or another person — any reward, advantage or benefit of any kind as consideration for doing or not doing, or for having done or not done, any act relating to the affairs or business of the agent's principal, or for showing or not showing favour or disfavour to any person with relation to the affairs or business of the agent's principal; or (b) with intent to deceive a principal, gives to an agent of that principal, or, being an agent, uses with intent to deceive his principal, a receipt, an account or other writing (i) in which the principal has an interest, (ii) that contains any statement that is false or erroneous or defective in any material particular, and (iii) that is intended to mislead the principal. |
| OSFI/ Financial Consumer Agency of Canada ("FCAC") | *Bank Act*, s. 455<br><br>*Insurance Companies A*ct, s. 486<br><br>*Complaints (Banks, Authorized Foreign Banks and External Complaint Bodies) Regulations*<br><br>FCAC Guidance CG-12 *Internal dispute resolution* | Complaints handling – s. 17(1) | Pursuant to Section 455 of the *Bank Act*, a bank must<br>(a) establish procedures for dealing with complaints made by persons having requested or received products or services in Canada from a bank, (b) designate an officer or employee of the bank to be responsible for implementing those procedures; and (c) designate one or more officers or employees of the bank to receive and deal with those complaints. In addition, pursuant to the *Complaints (Banks, Authorized Foreign Banks and External Complaint Bodies)* |

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| | | | *Regulations*, banks must report to the public the number of complaints received, the average length of time to deal with complaints and the number of complaints resolved satisfactorily. Equivalent requirements apply to Section 455 of the *Bank Act* apply to federally regulated insurance companies (s. 486 *Insurance Companies Act*).<br><br>In addition, the Financial Consumer Agency of Canada (which has jurisdiction over banks and federal trust companies but not federally regulated insurance companies) has issued Guidance CG-12 *Internal dispute resolution* which provides further guidance on the requirements in respect of such policies and procedures. |
| OSFI/ Competition Bureau | *Bank Act*, s. 459.1<br><br>*Competition Act*, s. 77 | Tied selling – s. 18(1), 18(2) | Section 459.1 of the *Bank Act* provides that a bank may not impose undue pressure on, or coerce, a person to obtain a product or service from a particular person, including the bank and any of its affiliates, as a condition for obtaining another product or service from the bank. In addition, the bank must disclose the prohibition on coercive tied selling in a statement in plain language that is clear and concise, displayed and available to customers and the public at all of its branches where products or services are offered in Canada, on all of its websites through which products or services are offered in Canada and at all prescribed points of service in Canada.<br><br>Section 77 of the *Competition Act* provides that where the Competition Tribunal finds that exclusive dealing or tied selling, because it is engaged in by a major supplier of a product in a market or because it is widespread in a market, is likely |

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| | | | to (a) impede entry into or expansion of a firm in a market, (b) impede introduction of a product into or expansion of sales of a product in a market, or (c) have any other exclusionary effect in a market, with the result that competition is or is likely to be lessened substantially, the Tribunal may make an order directed to all or any of the suppliers against whom an order is sought prohibiting them from continuing to engage in that exclusive dealing or tied selling and containing any other requirement that, in its opinion, is necessary to overcome the effects thereof in the market or to restore or stimulate competition in the market. |
| OSFI | OSFI Guideline B-7 *Derivatives Sound Practices*<br><br>*Securities Act* (Ontario), s. 126.1, 127<br><br>*Bhasin v. Hrynew*, 2014 SCC 71<br><br>*Competition Act,* Part VII.1 | Fair terms – s. 19(1), 19(2) | OSFI Guideline B-7 *Derivatives Sound Practices*, provides that a FRFI should act honestly and in good faith when marketing, negotiating, entering into, executing and administering transactions with its clients or counterparties. Staff who are involved in trading or providing advice in relation to derivatives trades should have the appropriate education, skills, experience and training to carry out their responsibilities.<br><br>Ontario securities regulators also have broad public interest powers under Section 127 of the OSA. In addition, separate from the public interest powers, the OSA also deals with fraud and with misleading or untrue statements.<br><br>More generally, the Supreme Court of Canada in *Bhasin v. Hrynew* recognized a general organizing principle of good faith in the performance of contracts throughout Canada. As a result of *Bhasin*, all contracts throughout Canada are subject to a duty of, at a bare minimum, honest |

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| | | | performance, which cannot be excluded by the terms of an agreement. These obligations apply only to the corporate counterparty, because of privity of contract, and not to individuals acting on behalf of the corporate counterparty. The exception to this would be an independent tort that would arise if the individual acted fraudulently.<br><br>In addition, certain deceptive marketing practices are criminal offences or reviewable matters under the *Competition Act*, including false and misleading representations to the public (which can include misrepresentations to businesses). |
| OSFI/ Securities commissions | NI 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* | Safeguarding of counterparty assets – s. 25, 26, 27(1), 27(2), 27(3), 28(1), 28(2), 28(3) | NI 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* requires segregation of assets.<br><br>OSFI Guideline E-22 *Margin Requirements for Non-Centrally Cleared Derivatives* establishes minimum standards for margin requirements for non-centrally cleared derivative transactions undertaken by FRFIs. Assets delivered for initial margin must be segregated and no re-hypothecation is allowed. Assets delivered for variation margin are not required to be segregated and it can be implied that re-hypothecation would be allowed. |
| OSFI | OSFI Guideline B-7 *Derivatives Sound Practices*<br><br>OSFI Guideline D-6 *Derivatives Disclosure* | Mandatory disclosure to counterparties – s. 35(1), 35(2), 20(1), 20(2), 20(3) | OSFI Guideline B-7 *Derivatives Sound Practices* states that FRFIs should seek to agree in writing with counterparties to all material terms governing their trading relationship prior to or at the time of execution of a non-centrally cleared derivative.<br><br>In addition, OSFI Guideline D-6 *Derivatives Disclosure* |

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| | | | supplements guidance set forth in IFRS 7 which provides disclosure requirements for financial instruments. The Guideline addresses disclosure in the FRFI's annual report and OSFI annual returns, in particular with respect to notional amounts, other derivatives disclosure and positive replacement cost, credit equivalent amount and risk-weighted equivalent. |
| OSFI | OSFI Guideline B-7 *Derivatives Sound Practices* | Reporting to counterparties – s. 22, 29(1), 29(2), 29(3), 29(4), 30(1), 30(2), 30(3) | OSFI Guideline B-7 *Derivatives Sound Practices* provides that a FRFI should establish and implement processes and procedures that allow it to confirm the material terms of bilateral derivatives transactions in a timely manner after execution to reduce the potential for losses from market risk or other sources. Where practicable based on the nature, size and complexity of the FRFI and its derivatives activities, electronic methods and standard settlement instructions should be used to maximize the use of straight through processing (STP) and allow for prompt confirmation and affirmation. In addition, OSFI expects that a FRFI report derivatives transactions to a recognized trade repository, following the derivatives data reporting requirements that have been adopted in the province in which the head office and/or principal place of business of the FRFI is located ("local reporting requirements"). |
| OSFI | *Bank Act*, s. 238, 239, 597<br><br>*Insurance Companies Act*, s. 261, 262, 647<br><br>OSFI *Supervisory Framework*<br><br>OSFI Guideline B-7 *Derivatives Sound* | Record-keeping – s. 36 | Sections 238, 239 and 597 of the *Bank Act* generally require banks carrying on business in Canada to maintain records in Canada and to ensure that OSFI can access in Canada any records necessary to enable OSFI to fulfill its supervisory mandate. In particular, pursuant to Section 238 of the *Bank Act*, a bank must prepare and maintain records |

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| | *Practices* | | containing the following (a) the incorporating instrument and the by-laws of the bank, (b) minutes of meetings and resolutions of shareholders and members, (c) the names of directors and auditors, (d) particulars of any authorizations, conditions and limitations established by OSFI in respect of the commencement and carrying on of business of the bank that are from time to time applicable to the bank, (e) particulars of exceptions granted in respect of any discontinuance, permission to a subsidiary of a foreign bank, or a sale of all or substantially all of its assets that are from time to time applicable to the bank; and (f) particulars from Schedule I or II that are applicable to the bank as they are from time to time amended and published in the Canada Gazette.<br><br>In addition, a bank must prepare and maintain adequate (a) corporate accounting records, (b) records containing minutes of meetings and resolutions of the directors and any committee thereof; and (c) records showing, for each customer of the bank, on a daily basis, particulars of the transactions between the bank and that customer and the balance owing to or by the bank in respect of that customer.<br><br>Equivalent requirements apply to federally regulated insurance companies (s. 261, 262, 647 *Insurance Companies Act*) under the equivalent legislation.<br><br>In addition, OSFI's *Supervisory Framework* requires FRFIs to establish and maintain an enterprise-wide RCM framework of regulatory risk management controls, and these controls include oversight functions that are independent of the activities |

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| | | | they oversee. OSFI expects the RCM framework to include ''Adequate Documentation'' as one of its key controls.<br><br>As set forth in OSFI Guideline B-7 *Derivatives Sound Practices*, each FRFI should have mechanisms in place to assure the confirmation, maintenance, and safeguarding of derivatives contract documentation. In particular, it states:<br><br>"A FRFI should establish and implement processes and procedures that allow it to confirm the material terms of bilateral derivatives transactions in a timely manner after execution to reduce the potential for losses from market risk or other sources." |
| OSFI | *Bank Act*, s. 157, 465<br><br>*Insurance Companies Act*, s. 492, 615<br><br>OSFI Guideline E-13 *Regulatory Compliance Management*<br><br>OSFI Guideline B-7 *Derivatives Sound Practices*<br><br>OSFI Guideline B-1 *Prudent Person Approach*<br><br>OSFI Guideline B-2 *Large Exposure Limits*<br><br>OSFI *Corporate Governance Guideline* | Compliance and risk management – s. 32 | OSFI Guideline E-13 *Regulatory Compliance Management* provides that at a minimum, a FRFI should establish a regulatory compliance management (RCM) framework including the following, administered through a methodology that establishes clear lines of responsibility and a mechanism for holding individuals accountable: (i) role of the CCO; (ii) procedures for identifying, risk assessing, communicating, effectively managing and mitigating regulatory compliance risk and maintaining knowledge of applicable regulatory requirements; (iii) day-to-day compliance procedures; (iv) independent monitoring and testing procedures; (v) internal reporting; (vi) role of Internal Audit or other independent review function; (vii) adequate documentation; (viii) role of Senior Management, and (ix) role of the Board. |

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| | | | **Procedures for Identifying, Risk Assessing, Communicating, Managing and Mitigating Regulatory Compliance Risk and Maintaining Knowledge of Applicable Regulatory Requirements**<br><br>Reasonable procedures should exist to assure that appropriate individuals are provided with current and accurate information needed to identify, assess, communicate, manage and mitigate regulatory compliance risk, and maintain knowledge of applicable regulatory requirements. The procedures should enable a FRFI to take a risk-based approach to managing regulatory compliance risk so that appropriate resources are allocated to higher risk areas. The information provided should be updated, as necessary, to reflect new and changing regulatory requirements. In addition, such procedures should assure that information is updated when changes with respect to products, services, strategic plans, other activities and corporate structure are made.<br><br>**Day-to-Day Compliance Procedures**<br><br>Appropriate procedures should exist in operational management to reasonably assure that a FRFI is complying on a day-to-day basis with the regulatory requirements applicable to the activities of the FRFI. Such procedures should be tailored to the business activities. They should be incorporated into, and maintained in, relevant business operations. The procedures should also include a monitoring and testing component using a risk-based approach to |

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| | | | reasonably assure the adequacy of, adherence to, and effectiveness of such procedures in business operations.<br><br>In addition, OSFI Guideline B-7 *Derivatives Sound Practices*, sets out expectations with respect to risk management relating to the use of derivatives, reporting requirements to trade repositories and capital requirements for derivatives transactions.<br><br>**Prudent Business Practices**<br><br>Section 465 of the *Bank Act* (and Sections 492 and 615 of the *Insurance Companies Act*) require the board of a FRFI to establish investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments and loans to avoid undue risk of loss and obtain a reasonable return. Furthermore, a number of OSFI guidelines set out prudential limits and restrictions, including OSFI Guideline B-1 *Prudent Person Approach* and OSFI Guideline B-2 *Large Exposure Limits.* OSFI Guideline B-1 outlines factors that OSFI expects the management and the board of directors of a financial institution to consider in establishing investment and lending policies and in ensuring that they are effectively implemented. Pursuant to OSFI Guideline B-2, FRFIs are also expected to have in place the management information and control systems necessary to give effect to their written policies on large exposures. OSFI has also issued Guidance Note 03/2001 *Large Exposure Limits* providing additional guidance on the application of Guidelines B-1 and B-2.<br><br>**Risk Management Duties** |

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| | | | Section 157 of the *Bank Act* imposes a duty on the board of directors of a bank to manage or supervise the management of the business and affairs of the bank (there is a similar requirement under Section 165 of the *Insurance Companies Act*).<br><br>The OSFI *Corporate Governance Guideline* (“**OSFI Corporate Governance Guideline**”) requires that each FRFI establish a risk appetite framework (“**RAF**”) that:<br><br>• Guides the amount of risk the FRFI is willing to accept in pursuit of its strategic and business objectives.<br><br>• Sets basic goals, benchmarks, parameters, and limits, and should consider all applicable types of risks.<br><br>• Contains all elements required by an annex to the Corporate Governance Guideline, including a risk appetite statement, specific risk tolerance limits, and processes for implementation of the RAF.<br><br>Further, the OSFI *Corporate Governance Guideline* states that D-SIBs should establish a dedicated risk committee to oversee risk management on an enterprise-wide basis, and that the oversight of the risk management activities of the bank are to be independent from operational management, adequately resourced, and have appropriate status and visibility.<br><br>OSFI Guideline B-7 *Derivatives Sound Practices* states that each FRFI should ensure that each derivative product traded is subject to a product authorization signed off by senior management, and sets forth OSFI’s |

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| | | | expectations with respect to having documented policies and procedures for risk management, creating risk tolerance limits, and measuring, reporting, managing, and controlling the risks associated with the derivatives business, including market, currency, interest rate, equity price, commodity price, credit, settlement, liquidity, operational, and legal risks.<br><br>Finally, OSFI's oversight pursuant to the *Supervisory Framework* will assess the extent to which the risk management function integrates policies, practices, and limits with day-to-day business activities and with the bank's strategic, capital, and liquidity management policies. Under the Supervisory Framework, OSFI will assess whether the risk management function effectively monitors risk positions against approved limits and ensures that material breaches are addressed on a timely basis. OSFI will look at various indicators, including the extent to which the bank proactively updates its policies, practices, and limits in response to changes in the industry and in the institution's strategy, business activities and risk tolerances. |
| OSFI | OSFI Guideline E-13 *Regulatory Compliance Management*<br><br>OSFI *Corporate Governance Guideline* | Compliance officer – s. 33(1), 33(2), 34, 31 | OSFI Guideline E-13 *Regulatory Compliance Management* ("RCM Guideline") provides the CCO should be responsible for assessing the adequacy of, adherence to and effectiveness of the FRFI's day-to-day controls, and for providing an opinion to the Board whether, based on the independent monitoring and testing conducted, the RCM controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide.<br><br>Pursuant to the RCM Guideline: |

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| | | | • The compliance oversight function should be designated to a member of senior management as the bank's CCO;<br><br>• Such CCO should have sufficient stature, authority, resources, and access to achieve compliance with applicable law;<br><br>• Such CCO should have appropriate skills and knowledge to effectively fulfill the requirements of the function;<br><br>• The CCO should approve the content and frequency of reports and that such reports should be sufficient to enable the CCO, senior management, and the bank's board to discharge their compliance responsibilities;<br><br>• OSFI expects that each bank's RCM framework will include identification, assessment, communication, and maintenance of applicable regulatory requirements, compliance procedures, monitoring procedures, and reporting procedures;<br><br>• OSFI expects the CCO to be responsible for the RCM framework and to report issues directly to the board, including any material compliance issues and their remediation; and<br><br>• Normal course reports to the board should be made no less than annually, and contain discussion of material weaknesses, non-compliance issues, and remedial action plans. |

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| | | | In addition, the OSFI Corporate Governance Guideline states that the FRFI's board of directors should be responsible for the selection, performance, management, compensation, and evaluation of a CCO. |