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September 14, 2018

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

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and

Grace Knakowski
Secretary
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RE: Comments on Proposed National Instrument 93-102 Derivatives: Registration

Hamblin Watsa Investment Counsel Ltd. ("HWIC") is pleased to submit this comment letter in response to the Canadian Securities Administrators' ("CSA") notice and request for comments regarding Proposed National Instrument 93-102 *Derivatives: Registration* ("Proposed Instrument") and Proposed Companion Policy 93-102 *Derivatives: Registration* ("CP", together with the Proposed Instrument, the

"Proposed Registration Rule").[1] HWIC is a wholly-owned subsidiary of Fairfax Financial Holdings Limited ("Fairfax"), with its operations based in Toronto, Ontario.[2] HWIC provides investment management services exclusively to the insurance, reinsurance and certain other affiliates of Fairfax.

HWIC supports the efforts of the CSA to "help protect investors, reduce risk and, improve transparency and accountability in the over-the-counter (OTC) derivatives markets."[3] Further, HWIC appreciates the CSA's recognition in the Proposed Registration Rule that certain exemptions from registration as a derivatives adviser are appropriate. In particular, we are supportive of the inclusion of the exemption provided in Section 60 of the Proposed Registration Rule, which provides that a company is exempted from registration as a "derivatives adviser" in instances where it is only advising its "affiliated entit[ies]."[4] However, we believe that the terms and conditions around this exemption require further clarification. Accordingly, we have provided detailed comments on this clarification to Section 60, as well as related comments around the definition of what constitutes an "affiliated entity."

Proposed Section 60 should better promote centralized affiliate advising programs which improve corporate efficiencies and reduce risk.

The economic realities of today's markets often involve corporate groups engaging in multiple lines of business across disparate markets and geographies. Operations across various affiliates often introduce risks and inefficiencies that are exacerbated by deficient or inadequate centralization of management, expertise and oversight.

As a means to combat these risks and provide more fulsome, top-down supervisions, large companies often institute a centralized hedging and discretionary investment program, whereby the group consolidates its expertise into a single entity within the corporate group (a "PM"). In many instances the PM, in addition to performing a treasury-like function, provides investment management advice and services for its affiliates, which includes advice regarding derivatives. Structuring a corporate organization in this manner, with a centralized PM, promotes risk reduction and is an encouraged best practice, as it creates efficiencies across the company by leveraging talent, centralizing risk management oversight, streamlining decision-making, reducing redundancies, and ensuring consistency across affiliates. The PM's derivatives advising activities (and the PM's activities more generally) are purely inward facing and do not extend to third parties, limited solely to affiliates within its corporate group.

We appreciate the CSA's recognition in Section 60 of the Proposed Registration Rule that internal derivatives advising activities are distinguishable from third-party derivatives advising activities and should not be subject to derivatives adviser registration requirements. We note, however, that the exemption, as currently proposed, does not provide the regulatory certainty that is necessary in order to fully recognize the risk-reducing benefits of a PM. In particular, we note the following concerns.

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[1] Canadian Securities Administrators, *CSA Notice and Request for Comment, Proposed National Instrument 93-102 Derivatives: Registration and Proposed Companion Policy 93-102 Derivatives: Registration*, 41 OSCB 3253 (Apr. 19, 2018), *available at* http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20180419_93-102_rfc-derivatives-registration.pdf. [hereinafter the "Proposed Registration Rule"].

[2] HWIC is a registered portfolio manager with the Ontario Securities Commission ("OSC"), while Fairfax is a publicly-traded company whose principal regulator is the OSC.

[3] Proposed Registration Rule at 3254.

[4] Proposed Registration Rule at 3297.

The "investment fund" condition in the Proposed Registration Rule is overly broad and, consequently, must be further clarified.

The ambiguity created by the interplay between the exemption for advising affiliated entities in Section 60(1) and the limitation on advising affiliated "investment funds" in Section 60(2) should be clarified to exclude those instances where such affiliated investment funds' investors comprise of only affiliated entities. In particular, although Section 60(1) would generally provide an exemption for a person or company that is "advising an affiliated entity," Section 60(2) limits the availability of such an exemption if the advisee is an "affiliated entity that is an investment fund." Consequently, Section 60(2) would appear to preclude to a PM from qualifying for the exemption in Section 60(1) if the PM advises any affiliated investment fund. We believe that the limitation in Section 60(2) should be clarified to preclude from the exemption in Section 60(1) only those entities that advise an affiliated investment fund owned (i.e., invested in) by third-parties.

We note that an investment fund that is owned solely by affiliated entities of the same corporate group is distinguishable from an investment fund that is owned, in part, by third parties. We recognize that in many instances an affiliated investment fund is subject to a disparate ownership base comprised of third-party investors, and in such instances it may be reasonable to treat a company's derivatives advice as a third-party adviser relationship subject to registration requirements; however, Section 60(2), as drafted, ignores those instances where a company is providing derivatives advice to an affiliated investment fund that only has investors from within its affiliated corporate group. Indeed, investment funds are often used within a corporate group in order to provide an efficient investment mechanism for multiple affiliates within the corporate group—much like a PM serving as a centralized unit in which to advise the corporate group.

While we support the inclusion of the exemption in Section 60(1) of the Proposed Registration Rule, we believe the investment fund condition in Section 60(2) of the Proposed Registration Rule requires clarification to ensure that advising affiliated investment funds that are entirely owned by affiliates of a corporate group, with no outside investors, would not trigger registration as a derivatives adviser as, in this instance, such registration would not serve the intended purpose of Section 60(1) and would run contrary to the CSA's distinction between affiliate-based and third-party adviser services.

The "advising others" standard cannot be logically read to include inter-affiliate derivatives advice and, consequently, Section 60(2) should be clarified in the Proposed Registration Rule.

The CSA Derivatives Committee has explained that a "derivatives adviser" is a "[p]erson[] carrying on the business of advising others in relation to derivatives, or who hold[s] [themselves] out to be in that business in any Canadian jurisdiction."[5] We are in agreement with this interpretation and note that this explanation is supportive of our request for clarification to Section 60(2) of the Proposed Registration Rule. We respectfully request that a clarification make clear that Section 60(2) only precludes from the registration exemption in Section 60(1) of the Proposed Registration Rule, those entities that are advising affiliated investment funds owned (i.e., invested in) by one or more third-parties.

In particular, we posit that a logical reading of the CSA Derivatives Committee's explanation is that a PM cannot be "advising others" or be considered to be holding itself out as being in the business of providing derivatives advice in instances where the PM is only providing advice to affiliates (including affiliated investment funds owned solely by affiliated entities, with no third-party investors) of its corporate group. Indeed, it would be illogical to conclude that a PM—which is advising an affiliated

[5] CSA's Derivatives Committee Consultation Paper 91-407 Derivatives: Registration (Apr. 18, 2013).

investment fund whose only investors are affiliates[6]—is "advising others" or holding itself out to third-parties when the only entities involved are part of the same corporate group as the PM. Moreover, we note that the OSC has granted similar exemptions from adviser registration in the securities and commodity futures contexts on the basis that a company that is only advising affiliates is not "advising others"[7]. In contrast, the distinction between affiliated investment funds owned by third-parties and those owned only by affiliated entities is clear, as the former illustrates a clear nexus to a third-party, and therefore logically constitutes the act of "advising others" as set forth in the CSA Derivatives Committee's interpretation.

Notwithstanding the intent behind "advising others" and holding out to be in the business of derivatives advice, a plain text reading of Section 60(2) is ambiguous. Accordingly, we urge the CSA to make clear that an advising company may qualify for the Section 60(1) exemption for advising affiliated entities if it advises an affiliated entity that is an investment fund where such affiliated investment fund (i) is wholly-owned by unitholders who themselves are affiliated entities within the corporate group and (ii) the advising company, the unitholders, and the investment fund all constitute affiliated entities that are under the same beneficial ownership and control.

Definition of "affiliated entity"

HWIC supports the proposed definition of "affiliated entity" in Section 1(3) which establishes that persons or companies will be considered to be affiliated entities if one controls the other or if the same person or company controls both, as well as the proposed test for "control" set forth in Section 1(4).[8] We believe the "control" based definition of "affiliated entity" provides greater certainty to

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[6] These internal investment funds do not permit outside investors (i.e., no third-party investors) and are wholly-owned by the same parent company as their affiliates.

[7] *See, e.g.*, In the Matter of *The Securities Act*, R.S.O. 1990, c. S.5, as amended (The Act) and In the Matter of Swiss Re America Holding Corporation, Swiss Reinsurance Company Ltd, Swiss Re Corporate Solutions Ltd and SR Corporate Solutions America Holding Corporation (Sept. 9, 2016) ("… they were not providing advice to others with respect to investing in securities or buying or selling securities because they were providing such advice only to affiliates or special purpose entities within the Swiss Re Group."); In the Matter of *The Securities Act*, R.S.O. 1990, c. S.5, as amended (The Act) and In the Matter of MEAG MUNICH ERGO Asset Management GmbH (Mar. 28, 2018) ("… was not providing advice to others with respect to investing in securities or buying or selling securities because it was providing such services only to affiliates within the Munich Re Group, and that its provision of such services did not constitute the "engaging in the business" of an adviser."); In the Matter of *The Commodity Futures Act*, R.S.O. 1990, Chapter C.20, as amended (The CFA) and In the Matter of DuPont Capital Management Corporation (July 13, 2018) (providing an exemption from the adviser registration requirement for a company acting as an adviser in commodity futures and options contracts "for a pension fund sponsored by an affiliate for the benefit of the employees of the affiliate.").

[8] Section 1(4) provides that "a person or company (the first party) is considered to control another person or company (the second party) if any of the following apply: (a) the first party beneficially owns or directly or indirectly exercises control or direction over securities of the second party carrying votes which, if exercised, would entitle the first party to elect a majority of the directors of the second party unless the first party holds the voting securities only to secure an obligation; (b) the second party is a partnership, other than a limited partnership, and the first party holds more than 50% of the interests of the partnership; (c) all of the following apply: (i) the second party is a limited partnership; (ii) the first party is a general partner of the limited partnership referred to in subparagraph (i); [and] (iii) the first party has the power to direct the management and policies of the second party by virtue of being a general partner of the second party; [and/or] (d) all of the following apply: (i) the second party is a trust; (ii) the first party is a trustee of the trust referred to in subparagraph (i); [and] (iii) the first party has the power to direct the management and policies of the second party by virtue of being a trustee of the second party."

companies than the CSA's alternative version of the definition of "affiliated entity" that is based on "consolidation" under accounting principles and described in Annex II of the Proposed Registration Rule. While it is generally the case that affiliates within a corporate group are consolidated in prepared financial statements, there may be regulatory or business reasons for a particular entity not being included on consolidated financial statements, including changes in accounting rules.

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Thank you in advance for your consideration of HWIC's comments in response to the Proposed Registration Rule. Please contact the undersigned at swilcox@fairfax.ca if you have any questions regarding our comments.

Respectfully submitted,

Sherry Wilcox
Vice President and Chief Compliance Officer