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Dear Sirs/Mesdames of:
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

Re: Canadian Securities Administrators ("CSA") Notices and Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101 *Derivatives: Business Conduct* (the "Business Conduct Proposal") and National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (the "Registration Proposal") (collectively the "Proposals")

This comment letter is submitted on behalf of the Canadian division ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the legislative proposals referred to above.

About AIMA

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment funds, futures funds and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises over 1,900 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2 trillion in assets under management. AIMA Canada, established in 2003, now has more than 150 corporate members.

The objectives of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to provide leadership to the industry and be its pre-eminent voice; and to develop sound practices, enhance industry transparency and education, and to liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management. The majority of assets under management are from high net worth investors and are typically invested in pooled funds managed by the member.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Advisers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit our web sites at canada.aima.org and www.aima.org.

Comments

Set out below are our comments on the Proposals, broken down between general comments and responses to specific questions from the Proposals relevant to our members, which have been replicated in each section for ease of reference.

AIMA Canada appreciates the opportunity to comment on these proposed changes, which if adopted could have significant consequences on Canada's investment industry.

We commend the CSA for their continuing analysis and consultation with respect to the issues and potential regulatory responses regarding the regulation of over-the-counter ("OTC") derivatives. AIMA Canada agrees that, in light of the 2008 financial crisis, enhanced regulatory oversight of the OTC derivatives market is required. We urge the CSA, however, to consider all regulatory developments, both internationally and domestically, and consider their effect on investors and advisers before imposing a potential additional layer of regulatory requirements that may in fact be unnecessary or the cost of which may outweigh the intended benefits.

GENERAL COMMENTS

1. ***Exemption of Foreign Exchange Forward Contracts and Swaps ("FX Forwards") from the Proposals***

The Proposals apply to OTC derivatives as defined by the various provincial regulations. In Ontario, OSC Rule 91-506 *Derivatives: Product Determination* effectively defines FX Forwards as OTC derivatives (which is consistent with the product determination rules in all other Canadian jurisdictions). **Notwithstanding this definition, AIMA Canada recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within defined parameters which**

are set out below.

Treatment of FX Forwards By Other Regulators

For the purposes of regulation, FX Forwards have been excluded from the definition of OTC derivatives, for the purposes of regulation, by other regulatory and oversight authorities. We recommend that this approach be followed by the CSA for both international consistency and to maintain the competitiveness of the Canadian investment industry.

- In November 2012, the U.S. Department of the Treasury issued a final determination that FX Forwards would be exempted from certain mandatory derivatives requirements as part of the implementation of the Dodd-Frank Act. As a result, the U.S. Commodity and Futures Trading Commission ("CFTC") exempted FX Forwards from various monitoring and reporting requirements.

- In March 2015, the Basel Committee on Banking Supervision (the "BIS Committee") and the International Organization of Securities Commissions ("IOSCO") issued a paper on Margin Requirements for Non-Centrally Cleared Derivatives. In Requirement 1, paragraph 1.1, of this paper the BIS Committee and IOSCO state that "The margin requirements described in this paper do not apply to physically settled FX forwards and swaps."

- In February 2017, the Office of the Superintendent of Financial Institutions exempted physically-settled FX Forwards from the requirement to deliver initial and variation margin in Guideline E-22 *Margin Requirements For Non-Centrally Cleared Derivatives*.

With respect to the FX Forwards market, the above exclusions were deemed acceptable in light of the following factors with respect to the FX Forwards market:

a) Foreign exchange is unique as an OTC derivative in that the vast majority of FX transactions are short-term, thereby posing significantly less counterparty risk requiring oversight and regulation.
b) Foreign exchange transactions worldwide are already subject to strong, internationally coordinated oversight through central banks, with a well-functioning settlement process.
c) The transactions are often closely tied to the participants' funding and liquidity management activities.
d) Physically settled foreign exchange transactions should be viewed as money market or funding products. By definition such transactions are an agreement to deliver the full principal amount of one currency in exchange for the full principal amount of another currency. There are no "derivative" aspects to these transactions as participants know the exact extent of their obligations throughout the life of the contract.

Given these factors AIMA Canada recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within the following parameters:

a) FX Forwards are used by an entity registered as a securities adviser for risk management or hedging purposes linked to securities advising activities;
b) The FX Forward contracts have fixed terms requiring a physical exchange of currency; and
c) The average maturity of the portfolio of FX Forwards of the registrant is less than one year.

2. Fees – Division 2 Suspension and revocation of registration – derivatives firms (Companion Policy of Registration Proposal)

The Companion Policy states that a registered derivatives firm must pay fees every year to maintain its registration and that of its sponsored individuals. AIMA Canada asks the CSA to ensure that any additional proposed fees to be proposed are minimized for existing registered firms when the proposals are published for consultation.

In particular we ask the CSA to confirm that there will not be any duplication of fees for registered individuals already acting in the same or similar capacities for their registered firms. In particular this would apply to the ultimate designated person ("UDP") and the chief compliance officer ("CCO") as they will likely be the same individuals under both the Registration Proposal and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"). It could also apply to an advising or dealing representative. There is no additional regulatory oversight required for an individual to be registered under both regimes, hence there should not be additional fees.

3. Exemption for International Derivatives Advisers

The Proposals provide for very limited exemptions for international firms, much more limited than the international exemptions found in NI 31-103. We recommend that the Proposals be aligned with NI 31-103 in this respect, to ensure harmonization across the regulatory regimes (which apply to the same set of regulated entities) and to avoid international firms avoiding the Canadian marketplace. It is not apparent to us why the international dealer exemption, the international adviser exemption and the international sub-adviser exemption, each as found in NI 31-103, cannot be mirrored for the OTC derivatives registration regime in the Proposals. We caution that not doing so may result in international firms being unwilling to provide services to the Canadian marketplace, which will ultimately harm Canadian investors by reducing choice and increasing costs.

To that end, **we recommend that:**

- An equivalent of the international sub-adviser exemption be available to firms with respect to OTC derivatives activities. It would be an unusual result that a firm relying on the international sub-adviser exemption for securities law purposes would have to register as a derivatives adviser, and be subject to extensive business conduct requirements, simply for sub-advising on a mandate that included OTC derivatives. As an international sub-adviser may only advise a registered Canadian adviser or dealer, specifically where that latter registered firm has agreed to ensure the international sub-adviser fulfill its fundamental obligations under Canadian securities laws, we do not see a policy concern arising as a result of the introduction of such an exemption in the Proposals.

- Equivalents of the international dealer exemption and the international adviser exemption be available to firms with respect to OTC derivatives activities. The terms of the these exemptions should be identical to the terms found in NI 31-103. We see no policy reason why such exemptions should not be available to firms that deal in or advise on OTC derivatives.

If these exemptions are not included, international firms, operating both in the securities and the OTC derivatives space, would face the unusual regulatory outcome of having to comply with one set of exemptions for their securities activities, and other set of requirements for their OTC derivatives activities, with no apparent reason or justification for this different regulatory treatment.

4. Senior Derivatives Manager

We have concerns with the multiple oversight and supervisory roles presented in the Proposals. In particular, we have concerns with the senior derivatives managers position – firms with limited activity in OTC derivatives may cease to undertake such activities rather than sustain the cost and time to build out systems associated with this role. It is onerous to require firms to designate an additional un-registered individual who fulfils substantially the same role as registered individuals (UDP, CCO and CRO). We see this as a particular concern for international firms with a small number of Canadian clients. Imposing requirements that are inconsistent with other major jurisdictions, particularly the United States, could negatively impact in a decrease in the competitiveness of the Canada marketplace and ultimately result in less expertise being made available to Canadian clients.

CSA QUESTONS

Definition of eligible derivatives party
(Business Conduct Proposal Q#2, Registration Proposal Q#3)

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please

explain your response.

In our opinion the criteria are appropriate as they are largely consistent with the definition of Permitted Client under NI 31-103. We strongly encourage consistency between the instruments given that the Proposals contemplate a parallel or overlapping registration regime.

Application of derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation
(Registration Proposal Q#4)

We understand that a registered adviser under securities or commodity futures legislation may provide advice in relation to derivatives or strategies involving derivatives or may manage an account for a client and make trading decisions for the client in relation to derivatives or strategies involving derivatives. If the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities, we may consider the registered adviser/portfolio manager to not be "in the business of advising others in relation to derivatives".

> *(a) Do you agree with this approach? If not, why not? Alternatively, should we consider including an express exemption from the derivatives adviser registration requirement for a registered adviser under securities or commodity futures legislation? If yes, what if any conditions should apply to this exemption?*
>
> *(b) When should the provision of advice by a registered adviser/portfolio manager in relation to derivatives be considered incidental to the performance of their activities as a registered adviser/portfolio manager? What factors should we consider in distinguishing between registered advisers who need to register as derivatives advisers from registered advisers that do not need to register as derivatives advisers?*

Registered advisers under securities or commodity futures legislation ("securities advisers") should not be required to register as derivatives advisers where their advice with respect to derivatives is incidental to their securities advising because it is important to ensure (i) that the designation as a derivatives adviser is meaningful and does not automatically require all securities advisers to also register as derivatives advisers, (ii) that registration as a derivatives adviser is required only where such registration satisfies some regulatory vacuum, such as proficiency or investor protection, and (iii) on a cost-benefit analysis, any additional regulatory burden is not lightly imposed on participants in the investment management industry. Securities advisers and other participants in the asset management industry are already subject to constantly changing, overlapping and costly regulation across multiple jurisdictions.

We recommend that the CSA provide an express exemption from the derivatives adviser registration requirement for the benefit of the following three categories of securities advisers. Those managers of investment funds and accounts that (i) enter into derivatives transaction for the purpose of hedging against a particular identified risk that is inherent in the securities or other assets in which they typically invest, such as interest rate and currency exposures (to the extent that FX Forwards are not exempted as set out above), (ii) enter into one or more derivatives transactions for the purpose of obtaining a long or short exposure to the securities or other assets in which they typically invest directly, such as an equity swap, and (iii) otherwise enter into derivatives that are incidental or ancillary to their stated investment strategy. Many securities advisers that manage investment funds and accounts need to maintain the flexibility to enter into derivatives transactions to hedge against certain risks inherent in their respective portfolios and would benefit from having the ability to use derivatives to obtain exposure to a particular asset in the class of assets in which they typically invest. However, given a securities adviser's obligations to its clients under existing rules, it would be redundant to also require a securities adviser to also register as a derivatives adviser.

In order to qualify for such an exemption, the securities adviser should be required to enter into the trade with a registered derivatives dealer or a domestic or international derivatives dealer that is exempt from registration (including a federally regulated financial institution where such entities are exempt from registration). An additional requirement for relying on this exemption is that the stated investment strategy of the applicable investment fund or managed account should expressly provide in writing the core investment strategy and should include disclosure of the circumstances where the securities adviser may use derivatives pursuant to the exemption referred to in the Registration Proposal. In furtherance of this exemption, and to enhance the protection of the investors and beneficial owners of the funds and managed accounts, the definition of "eligible

derivatives party" should be amended in the Business Conduct Proposal so that investment funds and managed accounts advised by a securities adviser (in (k) and (l) of the definition) are not included in the definition. In the alternative, such investment funds and managed accounts should have to elect to be treated as an eligible derivatives counterparty. The later approach is probably appropriate for all of the parties that constitute eligible counterparties after part (c). Many of the parties referred to in (d) to and including (l) may benefit from the additional protections afforded to parties other than eligible derivatives parties under the Business Conduct Proposal.

Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives.
(Registration Proposal Q#6)

We understand Subsection 16(3) and subsection 16(4) provide an exemption from the requirement to register an individual as a derivatives dealing representative or as a derivatives advising representative in certain circumstances. Are the exemptions appropriate? In subparagraph 16(4)(b)(ii), individuals that act as an adviser for a managed account are not eligible for the exemption from the requirement to register as a derivatives advising representative. Is this carve out appropriate where an individual has discretionary authority over the account of an eligible derivatives party?

We believe that the exemptions in subsections 16(3)(a) and 16(4)(a) are not appropriate to the extent that they would still require registration when advising an affiliated investment fund. The majority of AIMA Canada's members manage proprietary or affiliated pooled funds sold to accredited investors. As the creators and managers of such funds they are intimately aware of their strategies and management. We do not believe there is any reason to distinguish proprietary investment funds from other affiliated entities; especially as such investment funds qualify as eligible derivatives parties. We recommend that affiliated investment funds not be carved out of the definition of affiliated entities.

It is also our opinion that the carve out in subparagraph 16(4)(b)(ii) with respect to managed accounts is not appropriate and is inconsistent in its application. Under the terms of the provision as written an individual would not be required to register as a derivatives advising representative if the firm is managing or sub-advising an arm's length investment fund since it is an eligible derivatives party and is not a managed account. However registration would be required for a managed account. So, for example, there are different registration requirements if a pension fund invests in an arm's length fund (no registration) vs. having the registrant manage a separate account for a pension fund (registration required).

There is an additional inconsistency between subsections 16(4)(a) and 16(4)(b). An individual would be required to register when advising a proprietary fund (s. 16(4)(a)) but not when advising an arm's length fund (s. 16(4)(b)). In our opinion there is no reason to distinguish the two instances when the same services are being provided.

These inconsistencies should be resolved such that the requirements are identical no matter the fund (proprietary or arm's length) or the vehicle chosen by the client (fund or managed account). We would agree with the suggestion to allow an exemption from registration when the managed account is held by an eligible derivatives party (i.e. subsection (b)(ii) should be deleted). Allowing such an exemption is consistent with the treatment of an investment by an eligible derivatives party in a fund and with the changes made in the Business Conduct Proposal that recognized that the managed accounts of eligible derivatives parties require less protection than non-eligible derivatives parties.

Specific Proficiency Requirements for Individual Registrants
(Registration Proposal Q#7)

Subsections 18(2) through (6) of the Instrument establish specific proficiency requirements for each individual registration category. Are these specific requirements appropriate? If not what specific exams, designations or experience are appropriate?

The Quebec regulator currently requires relevant experience relating to each type of derivatives instrument (futures, forwards, options, etc.) in respect of which an individual seeking registration as a derivatives advising representative pursuant to the *Derivatives Act* (Quebec) intends to advise, but this is not expressly set out anywhere. This has the practical effect of resulting in registered derivatives advisers being limited in respect of their derivatives advising activities to the types of instruments for which sponsored individuals have been

registered.

Unless the CSA wishes to create a regime where registered derivatives advisers are limited to particular categories of derivatives (in effect making each derivatives adviser a restricted derivatives adviser), we would recommend that the CSA clarify that any experience advising with respect to any category of derivatives is sufficient for an individual to be registered as a derivatives advising representative. It should be noted that individuals who advise with respect to one category of derivatives are invariably exposed to the entire universe of derivatives instruments and therefore are proficient across all types of derivatives instruments and underlyings.

Derivatives Ultimate Designated Person
(Registration Proposal Q#8)

Subparagraph 27(3)(c)(i) requires a derivatives firm's ultimate designated person to report any instance of non-compliance with securities legislation, including the Instrument, relating to derivatives or the firm's risk management policies if the non-compliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?

We believe that this requirement is not appropriate. It is the responsibility of the CCO and management to deal with such situations, including through the annual reports to the Board by the CCO and chief risk officer ("CRO"). We also note that this requirement would be inconsistent with any requirements under NI 31-103.

Minimum requirements for risk management policies and procedures
(Registration Proposal Q#10)

Section 39 sets out the minimum requirements for risk management policies and procedures. Are any of the requirements inappropriate? Are the requirements for an independent review of risk management systems appropriate?

In our opinion the requirements in subsection 39(2) for Board approval of risk management policies and procedures and subsection 39(4) for an independent review are not appropriate. These procedures will be a part of the overall policies and procedures of a firm. A registrant is already required to establish policies and procedures designed to establish a reasonable system of controls and supervision (section 38), consistent with the requirements of NI 31-103. The approval, administration and monitoring or review of policies and procedures is the responsibility of management and the CCO and CRO, including through the annual reports to the Board. Singling out the risk management policies and procedures for approval and review is not required as they are part of the overall management of the firm. These provisions would be inconsistent with NI 31-103, which has no equivalent requirements.

We also note that an independent review could be very costly, especially for a small firm without an internal audit function. It is unreasonable to expect such a review for a portion of a firm's systems that are already the responsibility of management and are subject to regulatory review.

Conclusion

In conclusion, AIMA Canada:

1. Recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within defined parameters, as outlined in this letter. This is consistent with international recommendations from both IOSCO and the BIS Basel Committee and practice in the U.S. and would preserve the competitiveness of the Canadian industry.

2. Harmonize the ongoing compliance requirements between the Proposals and NI 31-103 and eliminate the senior derivatives manager position requirements.

3. Harmonize the exemptions for international firms between the Registration Proposal and NI 31-103.

4. Exempt securities advisers from the requirement to register as derivatives advisers where their

activities are incidental to their securities activities and set out clear and actionable guidance for when a derivatives advising activity will be considered incidental to securities advising activities.

We appreciate the opportunity to provide the CSA with our views on the Proposals. Please do not hesitate to contact the members of AIMA set out below with any comments or questions that you might have. We would be pleased to meet with you to discuss our comments and concerns further.

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Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

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