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September 17, 2018

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Dear Sirs/Madams:

Re: Comments on Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy / Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy

The International Energy Credit Association **(IECA)** hereby submits the comments contained in this letter on behalf of its members in response to the solicitation for comments made by the Canadian Securities Administrators ("**CSA**") in respect of the following published documents:

Proposed National Instrument 93-101 *Derivatives: Business Conduct* **(Proposed Business Conduct Rule)**; and

Proposed Companion Policy 93-101 Proposed CP *Derivatives: Business Conduct* **(Proposed Business Conduct CP)**

(collectively, Proposed Business Conduct Instrument).

Proposed National Instrument 93-102 *Derivatives: Registration* **(Proposed Registration Rule)**; and

Proposed Companion Policy 93-102 *Derivatives: Registration* **(Proposed Registration CP).**

(collectively, Proposed Registration Instrument).

INTRODUCTION

The IECA is not a lobbying group. Rather, the IECA is an association of several hundred energy company credit management, contract administration and legal professionals grappling with credit-related issues in the energy industry.

The IECA seeks to protect the rights and advance the interests of the commercial energy end-user community that makes up its membership. The IECA membership includes many small to large energy companies, few of whom are likely to be deemed derivatives dealers in Canada, but all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that Canadian businesses and consumers require for our economy and our livelihood.

Correspondence with respect to this comment letter and questions should be directed to the following individuals:

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COMMENTS OF THE IECA

On April 18, 2013 the CSA published the CSA Consultation Paper 91-407 *Derivatives: Registration* which provided an overview of the CSA's proposal for the regulation of key derivatives market participants through the implementation of a registration regime and a compliance system/internal business conduct regime. The CSA has since decided to split the regulation in this space into two separate regulations: one national instrument for business conduct and one national instrument for registration.

On April 4, 2017, the CSA published the Proposed Business Conduct Instrument for comment. On June 14, 2018, the CSA republished the Proposed Instrument for a second request for comment. Also on April 19, 2018 the CSA published the Proposed Registration Instrument for comment. The IECA strongly believes that the Proposed Business Conduct Instrument and the Proposed Registration Instrument should continue to be moved forward in unison. The IECA is grateful for the opportunity to submit supplementary comments on the Proposed Business Conduct Instrument during the comment period for the Proposed Registration Instrument.

The IECA would like to express its general support of the Comment Letter from Eversheds Sutherland (US) LLP, on behalf of The Canadian Commercial Energy Working Group, to the Canadian Securities Administrators dated August 2, 2018 **(CCE Letter).**

GENERAL COMMENTS

The IECA believes that its members are mostly commercial hedgers or commercial hedging end-users and traders of derivatives (both exchange-traded and OTC) primarily for the purposes of hedging commercial risks and asset optimization. These hedging activities foster the development and continued operations of energy infrastructure, the production of energy, the marketing of Canadian natural resources to domestic and international markets and the insulation of customers from price volatility in energy markets. Though the IECA believes that few of its members are likely to be "derivatives dealers" or "derivatives advisers" as defined in the Proposed Registration Instrument, the IECA is offering the following comments in the event the CSA finalizes the Proposed Registration Instrument in its current form into a final national instrument in which those terms are construed too broadly, so as to apply to members of the IECA. The IECA respectfully submits that such a broad construction of the proposals in the Proposed Registration Instrument would have a materially adverse impact on Canadian energy commodity trading and Canadian energy derivatives markets.

The IECA notes that the CSA stated in its notice and request for comment that "the implementation of the Proposed Instrument is therefore subject to the Quebec National Assembly's decision to revoke this exemption" in the Quebec Derivatives Act **(QDA)** for accredited counterparties when they are trading with each other. Therefore, the IECA hereby respectfully asks of the Autorité des marchés financiers **(AMF)** Quebec whether the AMF has started or intends to start the legislative process in the Quebec National Assembly to revoke the registration exemption in the QDA for trades between accredited counterparties.

AFFILIATED ENTITY

Different definitions across different but related rules of the definition of "affiliated entity" would put Canadian companies at a material disadvantage relative to non- Canadian companies, especially U.S. companies who are often the counterparties in the energy space to Canadian energy companies and lend a lot of liquidity to the Canadian derivatives market. One of the key tenets of effective regulation of a market by regulators, the IECA recommends, would be harmonization of a definition such as "affiliated entity" in every national instrument, so market participants do not face an undue burden and hardship that would require an internal corporate restructuring of their organizations to be compliant and to enjoy certain exemptions that the Canadian rules offer affiliated entities.

From a review of the CSA published national and multilateral instruments so far under the mandate to reform the Canadian OTC derivatives market, there is only in one instance connecting affiliated entities by consolidated financial statements in the *National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives* under the Intragroup exemption. Sub-section 7(1) of NI 94-101 provides that *"a local counterparty is exempt from the application of section 3, with respect to a mandatory clearable derivative, if all of the following apply: (a) the mandatory clearable derivative is between a counterparty and an affiliated entity of the counterparty* ***if each of the counterparty and the affiliated entity are consolidated as part of the same audited consolidated financial statements*** *prepared in accordance with "accounting*

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principles" as defined in National Instrument 52- 107 Acceptable Accounting Principles and Auditing Standards". It is IECA's recollection, based on discussions surrounding the proposal of NI 94-101, that the rationale had little, if anything, to do with defining affiliated entities. Rather, it was a result of a discussion of what the availability of the intragroup exemption in NI 94-101 should be. From the proposed NI 94-101 to the final version that is in effect today, the CSA decided to remove this restriction of making consolidated financial statements necessary for prudentially supervised entities as well.

Therefore, the IECA respectfully submits that the control-based definition in the Proposed Registration Instrument, which the CSA has used in all other related rules and national instruments, should be the definition of an affiliated entity. The IECA recommends against adopting the proposed definition in Annex II and believes that using different definitions across different rules would materially disadvantage and cause confusion and additional regulatory burden on Canadian companies.

ELIGIBLE DERIVATIVES PARTY

The IECA supports the comments made in the CCE Letter on the broadening of the definition of eligible derivatives party **(EDP)** so it is consistent with existing derivatives regulations and has no additional comment. Regarding the specific question asked by the CSA whether the criteria paragraphs (m), (n) and (o) in the definition of EDP, the IECA submits that the comments in the CCE Letter address this question and it has no additional comment.

COMMERCIAL HEDGER

The Proposed Registration Rule defines a commercial hedger to mean:

> a person or company that carries on a business and that transacts a derivative that is intended to hedge risks relating to that business if those risks arise from potential changes in value of one or more of the following:
>
> (a) an asset that the person or company owns, produces, manufactures, processes, or merchandises or anticipates owning, producing, manufacturing, processing, or merchandising;
> (b) a liability that the person or company incurs or anticipates incurring;
> (c) a service which the person or company provides, purchases, or anticipates providing or purchasing.

The IECA appreciates the CSA clearly enumerating the items in the definition which provides some clarity on whether a derivative qualifies as a hedging transaction. However, it is unclear from the definition whether a derivative that mitigates a change in foreign exchange rates would qualify as a hedging transaction. The Proposed Registration CP explains that the "concept of 'commercial hedger' is meant to apply to a business entering into a transaction for the purpose of managing risks inherent in its business." The IECA believes that the CSA intends fluctuating foreign exchange rates to be an inherent risk in a business that is involved in international commercial transactions, such as the Canadian energy industry, where a company's working currency, the currency of index prices referenced in its transactions and currency of settlement may not be the same currency. For absolute clarity on this very common scenario, the IECA seeks a clear statement that derivatives that hedge this currency risk which clearly is not intended for speculative purposes

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would be a commercial hedging transaction. Furthermore, as a general statement, the IECA seeks more specific guidance on what transactions constitute a qualifying hedge, similar to what was provided by the Commodity Futures Trading Commission **(CFTC)** in the United States and the European Market Infrastructure Regulation **(EMIR)** by the European Union

Furthermore, the IECA specifically notes its supports of the CCE Letter regarding the importance of reducing the currently proposed $10 million net asset commercial hedger threshold. The membership of the IECA, we believe, are mostly commercial hedgers or commercial hedging end-users and traders of derivatives (both exchange-traded and OTC) primarily for the purposes of hedging commercial risks and asset optimization. Moving from the current regime under the provincial blanket orders having no asset threshold to one that sets a high threshold calculated on the inappropriate measure of shareholder equity will result in smaller companies being denied a tool to manage their risks, which ironically could lead to instability in the Canadian energy industry.

DERIVATIVES ADVISER

The definition of "derivatives adviser" is identical in both the Proposed Business Conduct Rule and the Proposed Registration Rule:

> "derivatives adviser" means
> (a) a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others in respect of derivatives, and
> (b) any other person or company required to be registered as a derivatives adviser under securities legislation;

The wording and guidance with respect to "advisers" is similar to National Instrument 31-103.

The Proposed Business Conduct CP and the Proposed Registration CP state that when making the determination of whether or not an entity is a "derivatives adviser", it should consider its activities holistically and without any particular weight to any one factor. Given the broad nature of the factors, many Canadian energy companies will find themselves captured by the derivatives adviser definition.

Accordingly a clear exemption from the requirement to register as a derivatives adviser is extremely important to energy market participants. The consequences of being deemed a derivatives adviser are significant and energy market participants therefore require certainty that their activities do not inadvertently move them out of the "end user" category into the "derivatives adviser" category. Any additional guidance the CSA could provide on the weighting of specific business triggers for energy market participants, and providing for a long transitional period in the Canadian rules from being an exempted end user to a derivatives adviser, would be essential. Many energy market participants do not have an abundance of resources (both information technology and people) at their disposal, as compared to their derivative dealer counterparts, which may strain their ability to handle know-your-client requirements, counterparty conflict of interest management, or disclosure obligations. In addition, energy market participants may not have the appropriate compliance management staff or individual representatives that have completed the extensive individual training requirements. Therefore,

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if a former end user energy market participant were to transition to the "derivatives adviser" category, it would take a significant amount of time and cost to get the proper processes, software and resources in place.

The proposed rules provide for some exemptions including providing non-tailored general advice, advising affiliates and providing relief for foreign advisers that are registered or authorized under their foreign derivatives legislation. Given the variety of transactions and business structures utilized by energy market participants (including asset management agreements that may include the use of derivatives and the complexity of hedging the risks of joint ventures), it will be difficult to know how the various securities commissions will "holistically" assess their many different activities and transactions. Any advice given by one energy participant to another with respect to a transaction would most likely need to be tailored and may be regularly facilitated based on the relationship between the parties. Further, an entity may want to assist a joint venture entity within its corporate structure with hedging but most likely that joint venture entity will not fall under the definition of "affiliate".

For the above reasons and given that energy market participants transact with other sophisticated energy market participants that are capable of assessing their own use of derivatives, it would be helpful to the energy industry to have an exception similar to the accredited counterparty exemption in Quebec. The statutory exemption under Section 7 of the Quebec Derivatives Act, Chapter I-14.01, for advisers who assist accredited counterparties would be preferred by energy market participants. The Derivatives Act exempts the offering of OTC derivatives from the qualification and authorization requirements (and also from the derivatives dealer registration requirement) where the activities are conducted exclusively with accredited counterparties by an accredited counterparty.

Any foreign derivative advisers (or advisers out of Quebec), including US energy companies will have a competitive advantage over Alberta and other Canadian energy companies that engage in similar activities if the requirements of the other jurisdictions are less stringent. The U.S. swap regulations exempt from CFTC regulatory oversight, within certain parameters, a category of advisors – "commodity trading advisors" – who provide tailored advice to their energy clients but do not have the authority to trade on their client's behalf. Canadian energy market participants would benefit from a similar exemption for providing "guiding" advice without the authority to transact. Again, in the energy industry the participants are sophisticated and do not require all the protections found under the various provincial securities regulations when advising with respect to derivatives with their energy counterparts. Without clear exemptions, many Canadian energy companies may be deemed to be "derivatives advisers" and will incur a substantial compliance burden for essentially the same type of trading activity and services that are conducted across the border in the U.S. or be forced to restructure their business to remain exempt in Canada.

BUSINESS TRIGGERS

The definition of "derivatives dealer" in the Proposed Registration Rule and the Proposed Conduct Rule is anchored to the activity of "engaging in the business of trading in derivatives" and "trading in derivatives for a business purpose". Clarity in the scope of what constitutes these activities is

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of fundamental importance since only parties that engage in those activities will be deemed to be derivatives dealers and therefore subject to the registration and business conduct requirements set forth in the Proposed Instruments.

Inconsistencies in exemptions concerning business purpose factors – "quoting prices". Section 37 of the Proposed Business Conduct Instrument and Sections 48 & 49 of the Proposed Registration Instrument provide exemptions from each Proposed Instrument for certain derivatives end-users, i.e. entities that are not in the business of trading in derivatives. The heading to Section 48 of the Proposed Registration Instrument suggests that Section 48 is intended to only apply to derivatives end-users in British Columbia, Manitoba and New Brunswick. Although not stated in the heading to Section 49 of the Proposed Registration Instrument, it appears that Section 49 is intended to apply in the rest of Canada except for British Columbia, Manitoba and New Brunswick. Also, it appears that Section 37 of the Proposed Business Conduct Instrument is intended to apply in all of Canada without exception. The IECA asks that the CSA please confirm if these inferences are correct?

Each Section noted above describes conduct that would qualify a party for exemptions to the registration and business conduct requirements of the Proposed Instruments. The exemption described in Section 48(c) of the Proposed Registration Instrument differs slightly from the exemptions described in Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument. Section 48(c) of the Proposed Registration Instrument reads as follows:

> (c) the person or company does not regularly quote prices at which they would be willing to transact a derivative or otherwise make or offer to make a market in a derivative;" [emphasis added]

Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument both read as follows:

> (c) the person or company does not regularly make or offer to make a market in a derivative with a derivatives party;

The concept of "quoting prices" has been removed from Section 49(2)(c) of the Proposed Registration Instrument and Section 37(1)(c) of the Proposed Business Conduct Instrument though it remains in Section 48(c) of the Proposed Registration Instrument. Whether or not this difference was intentional, the IECA respectfully suggests that the language in these Sections should be made consistent by removing the "quoting prices" concept from Section 48(c) of the Proposed Registration Instrument. The IECA believes that a consistent description of this end-user exemption across the Proposed Instruments will facilitate consistent interpretation and application of the Proposed Instruments across Canada.

Less ambiguous and more objective guidance generally. In IECA's September 1, 2017 letter to the April 4, 2017 version of the Proposed Business Conduct Instrument, the IECA, at page 11, urged the CSA to provide a clear, unambiguous definition of derivatives dealer. We expressed concern that the guidance on the business purpose factors was so ambiguous that it allowed for reasonable, but potentially conflicting, interpretations between a market participant and the CSA

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on whether an entity was a derivatives dealer, given the "holistic analysis" approach advocated by the CSA.

The IECA appreciates the clarifications made in the current version of the Proposed Business Conduct Instrument concerning the "quoting prices" concept; however, we believe that further clarifications should be made to the business purpose factors guidance, in both Proposed Instruments, to make that guidance more objective and less ambiguous.

Other factors that the CSA may consider. In both Proposed CPs the CSA states that, with respect to the business purpose factors, it considers the listed factors important, but that the list is not complete and that "other factors may also be considered". The IECA asks that the CSA please explain, or provide examples of, what "other factors" the CSA may consider.

Holistic analysis and weighting of factors. In both Proposed CPs the CSA states:

> In determining whether or not it is, for the purposes of this Instrument, a derivatives dealer, a person or company should consider its activities holistically. We do not consider that all of the factors discussed above necessarily carry the same weight or that any one factor will be determinative.

With respect to the quoted statement, the IECA requests that the CSA provide guidance concerning how it might rank the factors in terms of importance as part of a holistic analysis? Also, if meeting any one factor may not be determinative, what threshold of factors being met would be considered determinative?

Proprietary trading vs. dealing. Within the guidance in both Proposed CPs concerning several of the business purpose factors, the CSA appears to draw a distinction between acting as a derivatives dealer and engaging in derivatives transactions for a party's own risk management needs or to speculate in the market (i.e. "proprietary trading"). This distinction appears in the CSA's commentary addressing the "Acting as a market maker", "Transacting with the intention of being compensated", and "Directly or indirectly soliciting in relation to transactions" factors. In addition, the CSA makes the following statement (in the context of a person or company engaging in the discussed factors in an organized and repetitive manner):

> Similarly, organized and repetitive proprietary trading, in and of itself, absent other factors described above, may not result in a person or company being considered to be a derivative dealer for the purposes of the Instrument.

The IECA supports drawing a distinction between proprietary trading and activities that would deem a party to be a derivatives dealer. The IECA notes that a similar distinction between proprietary trading and swap dealing is made by the CFTC under its swap dealer definition. A clear distinction between derivatives dealing activity and proprietary trading activity should be made in Canada and we urge the CSA to further develop and define this distinction. For example, the CSA should provide a definition of "proprietary trading" within the Proposed Instruments themselves, rather than simply allude to this concept in the Proposed CPs.

With a clear definition of proprietary trading embedded in the Proposed Instruments, the next step would be to include proprietary trading as an express exemption within the current end-user exemptions in the Proposed Instruments. In other words, if a party engages only in proprietary trading, which is distinct from the trading derivatives for a business purpose factors, such party would not be deemed to be a derivatives dealer.

In the IECA's view, the CSA has already identified, in the Proposed CPs, activities that would comprise the basis for a definition of proprietary trading, for example, organized and repetitive trading by a party: (i) for purposes of accommodating its own risk management needs, including to hedge specific risks (i.e. a party acting as a "commercial hedger", which is already defined in the Proposed Instruments); and (ii) to speculate in changes in the market value of a derivative, including with the goal of realizing a profit from such changes. The IECA respectfully urges the CSA to turn the commentary about these activities into a clear, concise and substantive definition of proprietary trading within the Proposed Instruments.

Directly or indirectly carrying on the activity with repetition, regularity or continuity. The CSA states in both Proposed CPs that:

> Frequent or regular transactions are a common indicator that a person or company may be engaged in trading or advising for a business purpose. The activity does not have to be its sole or even primary endeavor for it to be in the business. We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose.

The IECA respectfully submits that this business purpose factor should either be deleted entirely from the guidance because the language above is so ambiguous and subjective as to be essentially incomprehensible or be modified to make clear that the activity is "market making activity". Otherwise, how should a party interpret "frequent or regular transactions", or "regularly trading or advising"? By what measures would the CSA determine frequency or regularity?

In addition, we believe that this particular guidance and factor is superfluous to, and potentially conflicts with, other guidance the CSA has provided with respect to the business purpose factors. The "frequent and regular transactions" concept is already adequately addressed within the guidance concerning being a "market maker" and "routinely standing ready" to transact a derivative in response to requests for quotes. It is conflicting because the "frequent and regular transactions" concept is directly at odds with the proprietary trading guidance, discussed above, which correctly recognized that parties could be trading in an organized and repetitive manner, for purposes of making profits, and yet not be deemed to be a derivatives dealer.

Consistency across all Canadian rules. There are a multitude of regulations, and more expected in the future, affecting derivative market participants who are derivatives dealers. The IECA requests that the CSA scopes the business triggers for the definition of derivatives dealer the same across all Canadian rules, current and future. Otherwise, compliance with the variously scoped rules will create administrative burdens and the inconsistency could make market participants vulnerable to inadvertent non-compliance. Respectfully, the IECA cannot see any basis for varying business triggers across the Canadian rules and views any inconsistency as raising needless complexity and risk.

CALCULATION OF NOTIONAL AMOUNT

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In response to the CSA's request to provide comment on the methodologies for determining notional amount, the IECA provides the following comments:

<u>Commodity Options and similar products</u>: Whether column 1 or column 2 is ultimately adopted by the CSA, the notional amount should be calculated using the delta-adjusted forward price, not the spot price. Use of the spot price is not appropriate when valuing deals with a maturity date that is not spot. In the CDE Guidance, Section 2.71 Delta was added into the final technical guidance in response to industry comments stating that the notional amount for options should be adjusted by the delta to reflect the probability of options being exercised. The delta adjusted notional amount reflects the volume of the option that is hedged by a party with a swap and is a more accurate representation of a party's position. ESMA has adopted delta for calculation of the notional amount for purposes of position limits under MIFID II. For example, a gas producer interested in locking in the price of future production may hedge price exposure by selling a swap at a fixed price of $3.00/MMBtu for a volume of 75,000 MMBtu. Alternatively, the producer may sell an option to hedge a comparable level of exposure by selling a call with a strike of $3.50/MMBtu for a volume of 300,000 MMBtu. The delta of the option is .25, resulting in an option delta position (300,000*.25=75,000) equal to the swap volume.

<u>Commodity Forwards and similar products:</u> Physically settled commodity forwards should be excluded from the de minimis notional amount calculation as such products are excluded under the product determinations.

<u>Commodity fixed/float swaps and similar products:</u> Neither methodology is an appropriate measure and, instead, the calculation of the notional amount of a commodity fixed/float swap and similar products should be identical to that for commodity basis swaps, namely, using the spread between the fixed price and the floating price. A calculation based on the fixed price leg of the fixed/float swap does not, it is respectfully submitted, lead to an appropriately calibrated systemic-risked based notional amount.

<u>Commodity Basis Swaps and similar products:</u> Whether column 1 or column 2 is ultimately adopted by the CSA, the price for basis swaps such as locational basis swaps and index swaps such as a gas index spreads should be the spread between the two floating prices specified in the contract, which is viewed as the price of the swap by market participants and is how these swaps are quoted and transacted in the energy commodity markets. Section 2.50 Price of the CDE Guidance recognizes that "[c]ommodity basis swaps and the floating leg of commodity fixed/float swaps, as it is understood in the information included in the data element spread may be interpreted as the price of the transaction".

Under a basis swap, a party's exposure under a basis swap is the spread – the difference in the movement of two prices with respect to one another and not outright price movements on one of the legs. Spread is approved for use by the CFTC in locational basis trades for purposes of the swap dealer de minimis calculation in its FAQ about Swap Entities from October 2012. For entities that engage in de minimis levels of swap dealing in both the U.S. and Canada, a consistent calculation under both regulatory regimes would provide certainty to such entities and reduce compliance burdens of performing two different calculations for the same types of activity.

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Under a gas index spread, one party exchanges the variability of one index for another. For example, in the natural gas markets, one counterparty might pay First of the Month Index price and receive Gas Daily price in exchange. Often, the notional amount of an index spread swap is small given the similarity in the market price of both indices in the forward months. The "fair market value", or "price", is the spread or difference between the two indices.

Commodity swaptions and similar products: Whether column 1 or column 2 is ultimately adopted by the CSA, the use of the delta-adjusted spot price should be used to calculate the notional amount for the reasons stated above under "Commodity options and similar products". It is incorrect to presume that an option is always exercised. If the swaption is exercised into a swap, the notional amount should then be adjusted to reflect the notional amount of the underlying swap transaction (e.g., fixed price*quantity for a fixed vs float swap).

Variable Price/Volume: Under either methodology 1 or 2, for transactions that have varying prices and/or varying volumes, the IECA suggests a weighted average calculation of the price or volume for purposes of the notional amount. The same approach should be taken for a derivative with a notional amount schedule. In addition, the determination of the total notional quantity (under methodology 1) or the monthly approximation (under methodology 2) should be based on the notional quantity that remains to be settled under the swap and not the notional quantity of the entire swap.

Preference for Regulatory Notional Amount Methodology: The Regulatory Notional Methodology, rather than the CDE Guidance Methodology, is a more appropriate approach because it excludes the duration of a swap from the calculation and uses a monthly approximation even with a threshold below $1 billion. The registration trigger is based on an entity being in the business of trading derivatives. If Dealer 1 trades one 30 year swap with 360 monthly calculation periods, Dealer 1 should not have the same notional amount for purposes of dealer registration as Dealer 2 that trades 360 separate monthly swaps. Dealer 2 has 360 times as much dealing activity as Dealer 1. Under the CDE Guidance Methodology, however, Dealer 1 and 2 would have the same notional amount calculation, which is an extremely unfair result for dealers that tend to trade longer dated deals. The right result is found if the Regulatory Notional Methodology is used where only a 1 month volume for Dealer 1's swap is used. If the duration of the derivative is less than 1 month, the total notional quantity would be the appropriate measure of the volume.

Multi-Leg Derivatives: In respect of call spread options, where there are 2 legs to a derivative and the legs are of "like" derivatives with the same volume such as a Buy of a Call Option at $3.25 and a Sell of a Call Option at $3.50 with a notional quantity of 10,000 MMBTU's, the notional amount calculation should be based on 10,000 MMBTU's and not 20,000. In respect of a three-way option collar, the notional amount of one of the "like" options should be added to the "non-like" option notional amount. For example, if a party is the buyer of call, buyer of put and seller of a put, the call option plus one of the put options volume should be added together as only two of the three options would ever be able to be exercised. In respect of a multi-leg derivative consisting of an option and a swap, the notional amount for each derivative type should be determined and then added together.

DE MINIMUS THRESHOLD

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The IECA seeks clarity with respect to the consideration of affiliates in the calculation of the de minimis threshold, specifically Section 51(3)(c) of the Proposed Registration Rule. Within an affiliated group of entities, only those entities that engage in dealing activities should be considered derivatives dealers for the purpose of calculation of the de minimis threshold. While a single affiliate group may have multiple derivatives dealers comprising the group, it should be recognized that an affiliate in that group may not be a derivatives dealer and, as such, that non-derivatives dealer affiliate should not be precluded from benefitting from the exemption just because a member of its group is a derivatives dealer.

Concerning the amount of the commodity de minimis exemption, market price is a component of the notional amount calculation for commodity swaps. As commodity prices rise, so too then will the notional amount calculation. Given the fluctuating nature of commodity prices, there should be a mechanism in the rule to allow the regulators to adjust the de minimis threshold based on a significant change in commodity prices for the major commodities such as gas, power and oil.

The IECA believes that derivatives that hedge or mitigate commercial risk, whether physical or financial, should be excluded from the notional amount calculations. Firstly, the rationale for derivatives dealer oversight does not apply to transactions used to hedge or mitigate commercial risk. The purpose of hedging or mitigating commercial risk is fundamentally different from the purpose of being in the business of trading derivatives or advising others on derivatives, holding itself out as being in the business or trading or advising, or engaging otherwise as specified in Section 6 of the Proposed Registration Rule. Secondly, excluding derivatives that hedge or mitigate commercial risk would align the Canadian rules with the approach taken by the CFTC and by EMIR. The IECA desires that the Canadian rules make it absolutely clear that the derivatives to be included in the calculation of the aggregate month-end gross notional amount are only those derivatives that a derivatives dealer enters into in connection with its business of trading derivatives.

PORTFOLIO RECONCILIATION REQUIREMENTS

Section 44(1) of the Proposed Registration Rule requires a registered derivatives firm to conduct a portfolio reconciliation at least once a year. This raises some questions of practical application. What if a counterparty refuses to engage in the reconciliation exercise? Is the derivatives firm then prohibited from transacting with that counterparty? The CFTC and EMIR have handled these issues by allowing swap dealers to have written policies and procedures in place that are reasonably designed to perform such reconciliation but if a counterparty does not want to engage in the portfolio reconciliation, the swap dealer is not in violation of the portfolio reconciliation requirements. The IECA seeks the CSA to provide similar relief to entities under the Canadian rules.

DISPUTE RESOLUTION

Section 42(1) of the Proposed Registration Rule requires a registered derivatives firm to enter into a written agreement with each derivatives party that establishes when a material terms or valuations discrepancy is considered a dispute and a process for resolving the dispute as soon as

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possible. Under Section 42(3), the registered derivatives firm must report an unresolved dispute to its board of directors and if the dispute is not resolved within 30 days of reporting to the board, the registered derivatives firm must notify the regulators. The IECA proposes that such a reporting requirement should be required only where one of the parties is a "Canadian counterparty".

Furthermore, the IECA proposes that registered derivatives firm should be able to report to the board of directors or an appropriate management committee authorized by the board or appropriate management committee and to the regulators only if the size of the dispute exceeds a material threshold, such as $10,000,000, similar to the requirements imposed by the CFTC in its external business conduct rules for disputes.

PROFICIENCY REQUIREMENTS FOR COMPLIANCE POSITIONS

The IECA understands the rationale and motivation for proposing proficiency requirements for Derivatives Chief Compliance Officers **(CCOs)** and Derivatives Chief Risk Officers **(CROs)**. However, considering that these proficiency requirements have not fully been established in Canada because of the newness in regulating the OTC derivatives market in Canada, it might be very difficult to have many candidates for these important roles to fit the proficiency requirements as provided in the Proposed Registration Instrument. Consequently, the IECA supports the suggestion in the CCE Letter that the CSA create an alternative path of qualification for the CCOs and the CROs if they do not meet all the requirements in the Proposed Registration Instruments.

REGISTRATION TIMING AND DEREGISTRATION

The IECA proposes that the CSA clearly specify the deadline by which entities must register once the registration threshold is met. Under its swap dealer rules, the CFTC has imposed a registration deadline of two months after the day an entity can no longer take advantage of the de minimis exception. The IECA believes that a two-month period is reasonable. The IECA further proposes a tolerance that provides relief from registration in limited circumstances in recognition of the dynamic reality of commercial business. Specifically, an entity should be relieved from having to register in the case it exceeds the registration threshold by no more than 20% in one quarter if, in and during the entirety of the next quarter, the entity remained under the threshold, similar to the CFTC Major Swap Participant rule in the United States. The IECA believes that the risk of non-registration in such circumstance is far overwhelmed by the administrative burden incurred by entities having to scramble to register while registration also becoming unnecessary in the next quarter. Registration in that context, therefore, serves no substantive regulatory function or purpose. Furthermore, once a derivatives dealer is registered pursuant to the rules, the IECA proposes that such entity should be able to withdraw its registration anytime during the one year window after the day an entity should be able to take advantage of registration exemption, provided that during the entirety of that window period and on the date of effective withdrawal the entity was, in fact, exempted from registration pursuant to the Canadian rules.

EXEMPTION UNDER PROPOSED REGISTRATION RULE FOR FOREIGN DERIVATIVES DEALERS

Section 54 of the Proposed Registration Rule provides exemptions for foreign derivatives dealers. The IECA appreciates recognition by the CSA of foreign rules similar to the Canadian rules that

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achieve the same regulatory purpose and result but believes that substituted compliance could be extended further without increasing risk. Specifically, the registration requirement should not be required of US entities that are not required to be registered as a swap dealer under the CFTC de minimis threshold rule.

EXEMPTION UNDER PROPOSED BUSINESS CONDUCT RULE

The Proposed Business Conduct Rule applies to all derivative dealers, subject to certain enumerated exemptions. Those exemptions do not include derivative dealers who are not required to be registered under the Proposed Registration Rule; however, the IECA submits that such registration-exempt derivative dealers should be exempted from the business conduct rules for reasons of efficiency, flexibility and simplicity of regulatory oversight, which would harmonize the Canadian rules with the U.S. in this regard. The same considerations made by the CSA in granting the various exemptions from the registration rule including the notional amount threshold for registration should also apply in assessing whether there are real incremental benefits to be gained, and of a magnitude that exceeds the regulatory burdens, in requiring registration-exempt derivative dealers to comply with the business conduct rules. Striking that balance of appropriate regulatory oversight, that is, having sufficient protective measures while managing flexibility to encourage commercial participation, with respect to registration requirements but not to business conduct requirements would produce an inefficient regulatory framework overall.

CONCLUSION

The IECA appreciates the opportunity to table our members' comments and concerns to the CSA. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member.

Yours truly,

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