Stikeman Elliott

DELIVERED BY ELECTRONIC MAIL **Without Prejudice**

September 17, 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

Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Fax: 514-864-6381
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA Notice and Request for Comment – Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* and CSA Notice and Second Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

1. INTRODUCTION

We submit the following comments in response to the Notice and Request for Comment published by the Canadian Securities Administrators (the "**CSA**") on April 19, 2018 with respect to Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed NI 93-102**") and Proposed Companion Policy 93-102 *Derivatives: Registration* ("**Proposed 93-102CP**") and in response to the CSA's Notice and Second Request for Comment published on June 14, 2018 with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* ("**Proposed NI 93-101**") and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* ("**Proposed 93-101CP**"). Collectively, Proposed NI 93-102, Proposed 93-102CP, Proposed NI 93-101 and Proposed 93-101CP are referred to as the "**Proposed Instruments**".

Thank you for the opportunity to comment on the Proposed Instruments. This letter represents the general comments of certain individual members of our Financial Products & Services practice group (and not those of the firm generally or any client of the firm) and are submitted without prejudice to any position taken or that may be taken by our firm on its own behalf or on behalf of any client.

All references to parts and sections are to the relevant parts or sections of the applicable Proposed Instrument.

2. GENERAL COMMENTS

As a general comment, we applaud the continued effort by the CSA to develop a harmonized framework for the regulation of over-the-counter ("**OTC**") derivatives in Canada and to streamline the fragmented regulatory landscape that existing and prospective derivatives dealers, advisers and other derivatives market participants must currently navigate.

We have elected to provide a single comment letter to address both Proposed NI 93-102 and Proposed NI 93-101 and their respective Companion Policies, as our comments, concerns and recommendations largely apply across the Proposed Instruments.

Our comments and recommendations in this letter relate to several principal themes. Respectfully, in our view,

1. the scope of the Proposed Instruments is overreaching and the rules are misaligned with the realities of both the Canadian OTC derivatives market and global derivatives regulation;
2. the publication of proposed rules with blank appendices impedes the ability of industry stakeholders to assess the real impact of the Proposed Instruments on their businesses and comment in any meaningful way;
3. the Proposed Instruments, as currently formulated, will discourage access by foreign derivatives dealers and advisers to the Canadian OTC derivatives market;
4. the exemptions from registration and business conduct requirements under the Proposed Instruments require additional consideration and revisions; and
5. certain of the self-reporting requirements under the Proposed Instruments are out-of-step with the existing securities regulatory framework and inappropriate, particularly as they interact with the substituted compliance exemptions.

We also address our concerns and make recommendations regarding a lack of harmonization across regulatory instruments and the resulting complexity and compliance cost and burden to Canadian derivatives market participants; the unnecessary introduction of a "senior derivatives manager" concept into established compliance regimes; and additional aspects of the Proposed Instruments and exemptions therefrom.

For the foregoing and other reasons, we believe that the greatest risk of impeding access and thus discouraging participation in Canadian OTC derivatives markets is going to be to Canadian participants that need the increased liquidity and efficiency provided by participating in the global derivatives market.

3. THE CANADIAN DERIVATIVES MARKET AND SCOPE OF THE PROPOSED INSTRUMENTS

As a general comment, we note that the Proposed Instruments draw heavily from the existing securities regulatory regime in Canada. While we support all CSA efforts to align the derivatives and securities registration-related regimes to the greatest extent possible to eliminate duplicative regulation and oversight of dealers and advisers, the CSA must present a derivatives framework that recognizes the fundamental differences between the OTC derivatives markets and securities markets in Canada. The derivatives market primarily functions to allow businesses and, to a much more limited extent, individuals to hedge commercial risks. It is essential that the Proposed Instruments reflect this hedging and the primarily non-retail aspect of OTC derivatives markets, rather than the investment and investor protection focus of securities markets. In our view, as currently drafted, the Proposed Instruments do not adequately take this important distinction into account and, consequently, incorporate concepts and provisions that are not appropriate for the regulation of the OTC derivatives market.

For example, the business triggers for determining the application of the rules under the derivatives regime should be specifically tailored to the OTC derivatives market and not simply borrowed from the business trigger indicators that have been historically relied upon in the securities market context. In particular, proprietary trading activity should not be a trigger for registration or determining the applicability of the business conduct rules, regardless of whether the trading activity is frequent or repetitive, or whether the party solicits the transactions. This is acknowledged only in each of the Companion Policies to the Proposed Instruments (wherein the CSA have stated that "organized and repetitive proprietary trading, in and of itself, absent other factors… may not result in a person or company being considered to be a derivatives dealer" for purposes of the Proposed Instruments); however, this position should be clearly set out in the rules to avoid any interpretive inconsistencies, and is particularly important to buy-side institutions such as pension funds.

In addition, we have significant concerns about the resulting lack of alignment of the Canadian OTC derivatives market regime with those of other jurisdictions, particularly given the relative size of the Canadian market. As noted below, the Proposed Instruments introduce potentially significant increased costs and complexity of compliance for OTC derivatives market participants, with the consequential risk that the Canadian market may become an expensive and burdensome regulatory outlier in the global OTC derivatives market. To continue to attract vital foreign participation in the Canadian OTC derivatives market and preserve its depth and liquidity, we respectfully encourage the CSA to focus on developing a regulatory framework that is broadly consistent with recommendations of the International Organization of Securities Commissions ("**IOSCO**") and that is no more onerous or stringent than the U.S. regime.

4. INCOMPLETE RULES

It is imperative that the CSA publish material regulatory proposals of this order with all relevant information, including completed appendices. In particular, we note the fact that the jurisdictions for which substituted compliance is contemplated and the equivalent regulatory requirements to be listed in the schedules to the Proposed Instruments were not identified in these proposals. Consequently, foreign market participants, Canadian financial institutions and IIROC dealer members have no ability to assess how the requirements under the Proposed Instruments will apply to them. This has rendered it more difficult for market participants to assess the real impact of each of the Proposed Instruments on their businesses and provide meaningful and constructive comments on the proposals. We respectfully request that the CSA include complete appendices and schedules in the next publication for comment and provide an extended comment period of no less than 120 days to facilitate a more informed and detailed analysis of the Proposed Instruments.

5. IMPACT ON FOREIGN DEALERS AND ADVISERS

Substituted Compliance

In general, we are supportive of the substituted compliance approach in the Proposed Instruments—particularly in respect of foreign derivatives dealers and advisers—subject to the following observations and recommendations.

We are of the view that the CSA should adopt broad, purposive and outcomes-based substituted compliance exemptions, rather than engaging in a granular rules-based mapping of comparative regulatory requirements. These exemptions should defer as much as possible to foreign rules given the efforts at the IOSCO level and among other global agencies and industry associations to coordinate and harmonize the regulation of OTC derivatives registration and market conduct globally. The CSA's approach to substituted compliance should follow the recommendations of the March

2014 *Report of the OTC Derivatives Regulators Group (ODRG) on Cross-Border Implementation Issues*[1] which stated that:

> "In line with the G20 Leaders' declaration of September 2013, as well as the G20 Finance Ministers and Central Bank Governors' communiqué of February 2014, ODRG members reached the following understandings with respect to the use of equivalence and substituted compliance as means of deference: a flexible, outcomes-based approach should form the basis of final assessments regarding equivalence and substituted compliance. The final assessments of a foreign regime for equivalence or substituted compliance should be based on regulatory outcomes of that foreign regime, taking into account the different frameworks, local market practices and characteristics across jurisdictions. An equivalence or substituted compliance assessment also should be based on an understanding that similar regulatory outcomes may be achieved through the implementation of detailed rules or an applicable supervisory framework, or both. Such assessments may be made on a broad category-by-category basis, rather than on the foreign regime as a whole. An equivalence or substituted compliance assessment should fully take into account international standards, where they are appropriate, regulatory arbitrage, investor protection, risk importation, prudential and other relevant considerations." [emphasis added]

Given the comparatively small size of the Canadian OTC derivatives market globally, we do not see any compelling policy rationale for the implementation of Canadian requirements that impose duplicative, differential or additional obligations on market participants that are already governed by substantially equivalent requirements in major derivatives markets.

Given the state of derivatives rulemaking globally, we respectfully urge the CSA to defer to the lead foreign regulator's supervision and oversight over the foreign firm and to principles of reciprocity and principles-based substituted compliance, and ask that the CSA remove these conditions in the next draft of the Proposed Instruments.

Conditions of Reliance

We respectfully submit that the requirements under Proposed NI 93-102 for compliance with equivalent requirements or guidelines under the laws of the foreign jurisdiction are inconsistent with and more stringent than the international dealer exemption and international adviser exemption applicable in the securities market context under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"), for no apparent policy reason. As currently contemplated in Proposed NI 93-102, the derivatives dealer and adviser registration exemptions in sections 52 and 59, respectively, of Proposed NI 93-102 are only available where a foreign firm is subject to and in compliance with the requirements of the laws of its home jurisdiction (noting that the appendices of foreign jurisdictions and prescribed laws were not published with Proposed NI 93-102). However, if a foreign firm relies upon an exclusion or exemption (including discretionary relief) from the requirements of its home jurisdiction, the exemptions under Proposed NI 93-102 are unavailable.

Notably, this condition for reliance would give rise to significant interpretation, technical, compliance and enforcement issues which would ultimately render these exemptions unworkable. For example, it would effectively imply a compliance certification by the authorized signatory of Form 93-102F2 *Submission to Jurisdiction and Appointment of Agent for Service,* at personal risk to that signatory. This type of certification would be unrealistic to expect at the point of filing (e.g., without up-to-the moment enterprise-wide internal due diligence). In particular, we think it would create intractable

[1] A copy of the report is available on the U.S. Commodity Futures Trading Commission website at: https://www.cftc.gov/sites/default/files/idc/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf

issues for large multi-divisional financial services groups with separate business units and compliance divisions. Accordingly, we would ask that the CSA consider removing the requirements.

With respect to sections 52(1)(d) and 59(1)(d) of Proposed NI 93-102, in our view, the requirement to promptly notify the local Canadian regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction is similarly unworkable and, accordingly, we recommend that it be removed. See our discussion under "Self-Reporting Requirements" below.

The exemptions set out in NI 93-102 sections 52 and 59 would already be restricted to firms operating in foreign jurisdictions determined by the CSA to have equivalent requirements, a condition which does not exist under the international dealer exemption and international adviser exemption requirements under NI 31-103. Moreover, we believe it would be appropriate for these exemptions to be framed on a basis that is similar to the international dealer exemption and the international adviser exemption under NI 31-103. Under these exemptions, specific disclosure is required to be provided regarding the regulatory status of the international participant, thereby allowing the permitted client (which is a carefully circumscribed, narrow category of investors) to determine for itself whether it wishes to engage with the foreign exempt firm.

We note that the requirements under sections 54(1)(c) and 61(1)(c) of Proposed NI 93-102 to notify the local regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction is also unworkable from a cross-border compliance perspective and inconsistent with the existing compliance, self-reporting and enforcement framework of securities regulation. Accordingly, we suggest that these requirements also be removed.

Further, it is our view that it should be sufficient that a foreign dealer or adviser seeking to rely on the registration exemptions in Proposed NI 93-102 or the business conduct exemptions in Proposed NI 93-101 be registered, licensed or authorized under the rules of one of the jurisdictions specified in the applicable appendices, without that jurisdiction having to be the firm's *home* jurisdiction. For example, a dealer that is a registered swap dealer under CFTC rules but not subject to registration, licensing or authorization in its home jurisdiction should be eligible to rely on the exemption.

These technical issues alone could create a material disincentive for foreign firms and advisers to rely on the exemptions, with consequential adverse effects on liquidity in the comparatively small Canadian OTC derivatives market.

Foreign Dealers and Advisers and the Business Conduct Rule

In respect of Proposed NI 93-101, we have concerns that the implementation of a two-tiered approach to the imposition of business conduct requirements to market participants in the Canadian derivatives market is at odds with the established framework for the regulation of market intermediaries in Canadian capital markets. In particular, as currently drafted, Proposed NI 93-101 would impose additional layers of both principles-based and prescriptive rules on foreign derivatives market participants in a manner that materially differs from the framework applicable to foreign exempt firms operating on the basis of filings-based and other exemptions available to foreign market participants under NI 31-103.

For example, the "fair dealing" model and the corresponding requirement to "act fairly, honestly and in good faith", the rules governing the identification and management of conflicts of interest and know-your-derivatives party (gatekeeper) obligations may be broadly consistent with IOSCO policy objectives. These obligations may not, however, be implemented in the regulatory frameworks applicable to market participants in the major derivatives markets globally in a manner that can be easily reconciled with the substantive requirements of Proposed NI 93-101.

Respectfully, the CSA has not articulated a compelling rationale for the application of these "first tier" requirements to foreign firms that may, for the most part, already be subject to adequate market protection requirements in the global jurisdictions. Even for leading players in the global derivatives markets, the technical compliance challenges surrounding the interpretation of these differential requirements and the development of additional compliance systems to specifically address Canadian-specific market conduct requirements in the institutional market may simply not be worth the trouble. This proposal, combined with the material technical issues surrounding the filings-based exemptions for foreign derivatives dealers and advisers as currently proposed, may have a very real adverse impact on the cross-border OTC derivatives market. We strongly recommend that the terms and conditions of these exemptions be much more closely aligned with the terms and conditions of the international dealer and international adviser exemptions under NI 31-103 which the CSA successfully introduced into the cross-border securities market almost ten years ago.

Further exemption recommendations applicable to foreign derivatives dealers and advisers

Trades through a dealer - We respectfully suggest that the CSA include an exemption for transactions through or to a derivatives dealer that is registered or exempt from registration or otherwise subject to prudential supervision, similar to the inter-dealer exemption set out in section 8.5 of NI 31-103.

Foreign sub-advisory arrangements - We also recommend that the CSA provide an exemption analogous to section 8.26.1 of NI 31-103 (international sub-adviser exemption) to facilitate sub-advisory arrangements between Canadian registered derivatives portfolio managers and foreign managers that employ OTC derivatives trading strategies.

Importantly, the above-referenced exemptions under NI 31-103 are partly based on the premise that any investor protection or public policy concerns are addressed by the fact that such transactions are made through appropriately registered entities.

Trades with EDPs - Since cross-border derivatives transactions may involve multiple business units operating in affiliated firms (e.g., with counterparties potentially interacting with marketing teams, negotiation/documentary teams, finance teams and booking centres in different affiliated entities), we respectfully suggest that Proposed NI 93-102 more accurately address these commercial realities through additional exemptions (similar to subsections 16(3) and (4) for individuals) that would eliminate the need for duplicative registrations and exemptions in the case of transactions with EDPs.

In addition, we respectfully suggest that Proposed NI 93-101 should provide an exemption from relationship disclosure information requirements under section 18, transaction information reporting requirements under section 27 and derivatives party agreement requirements under section 33 where a derivatives firm complies with substantially equivalent harmonized disclosure, reporting and documentary practices that may be developed from time to time by global trade associations in standard industry documentation based on requirements applicable in the major global markets.

In our view, these additional exemptions are necessary and desirable to facilitate the maintenance of longstanding trading and advisory arrangements in the institutional market, particularly where a foreign derivatives participant may not be inclined to rely on the registration exemptions for foreign derivatives dealers and foreign derivatives advisers given the technical compliance challenges associated with those exemptions.

6. EXEMPTIONS FROM THE REQUIREMENT TO REGISTER

In addition to our comments above regarding the exemptions specifically applicable to foreign dealers and advisers under Proposed NI 93-102, we also make the following observations and recommendations:

Trades with an "eligible derivatives party"

We are generally very supportive of the concept of a uniform definition in all Canadian jurisdictions of an eligible derivatives party ("**EDP**") to classify sophisticated derivatives market participants. However, we respectfully suggest that—notwithstanding the differences in securities and derivatives markets, and acknowledging the CSA's response to this feedback following the first comment period relating to Proposed NI 93-101—the definition of EDP should be fully harmonized with the definition of “permitted client” under NI 31-103 and that a single term (e.g., “permitted party”) should be used to assist firms in streamlining client screening procedures and systems. Any additional derivatives-specific conditions (e.g., the derivatives-related knowledge and experience requirements in paragraphs (m), (n) and (o) of the definition of an EDP in Proposed NI 93-101 and Proposed NI 93-102) could be incorporated as additional counterparty qualification requirements.

We support the addition of the new “commercial hedger” category of the EDP definition; however, in our view, the minimum net assets condition for commercial hedgers should be eliminated. Under the *Derivatives Act* (Québec) (“**QDA**”) and existing blanket exemption orders applicable in many Canadian jurisdictions (e.g. Blanket Order 91-501 (BC) *Over-the-Counter Derivatives* and Blanket Order 91-507 (AB) *Over-the-Counter Trades in Derivatives*), the qualification of commercial hedgers is not contingent on any net asset condition. The Proposed Instruments purport to restrict this category and consequential access to commercial hedging solutions with no clear policy justification for doing so. Accordingly, we respectfully recommend that the minimum net assets condition in subparagraph (n)(ii) of the EDP definition be deleted.

We note that the definition of EDP includes a category for persons or companies acting on behalf of a “managed account” if certain conditions are met. With reference to paragraph 1(6) in each of Proposed NI 93-101 and Proposed NI 93-102, the purpose of qualifying the definition of “managed account” by reference to “a managed account owned by another person or company” is unclear. This language is inconsistent with the framework of existing exemptions for managed accounts and, in our view, should be removed.

Under paragraph 1(7) of each of Proposed NI 93-101 and Proposed NI 93-102, in determining whether a derivatives party is an EDP, a firm may not rely on a written representation if reliance on that representation would be “unreasonable”. We respectfully suggest that, rather than precluding reliance on a written representation based on a subjective standard of “unreasonableness”, the CSA should consider amending this provision to permit a firm to rely on written representations or other factual statements made by the other party, provided that it does not have reasonable grounds to believe that such representations or factual statements are false. See, for example, the guidance set forth in AMF *Policy Statement Respecting Accredited Counterparties* (Derivatives Act).

In addition, we respectfully submit that the definition of “commercial hedger” should be framed more broadly, consistent with existing definitions of “hedging” under the QDA and various provincial blanket orders, to more clearly capture ordinary commercial hedging activities (e.g., manufacturing inputs, currencies, commodities, interest rates, etc.). Further, the references in Proposed 93-102CP and Proposed 93-101CP to a “significant link” between the transaction and the business risks being hedged is unclear, nor is it clear how this concept reconciles with the definitions of “hedging” in National Instrument 81-102 *Investment Funds* and existing provincial rules. Finally, the new definition refers to “risks that arise from potential changes in value of one or more” of an asset, liability or services. The reference to “value” in that definition is challenging, as the hedger is hedging against the change in the price or cost of an asset, liability or services, rather than its value once owned. Accordingly, we would suggest that the CSA consider leveraging existing definitions for this purpose and clarify the related guidance.

Similar to the exemption from registration under Proposed NI 93-102 for clearing agencies, other entities that are registered or recognized (or exempted therefrom) under applicable Canadian securities laws, such as swap execution facilities and other derivatives trading facilities, should be specifically exempted from application of the Proposed Instruments as well.

Respectfully, the CSA in the jurisdictions outside of Ontario should take this opportunity to fully extend the firm level registration exemptions available under the *Securities Act* (Ontario) to specified financial institutions operating in the other Canadian jurisdictions on the basis that these market participants are otherwise already subject to robust prudential regulation by their principal regulators.

7. EXEMPTIONS FROM THE BUSINESS CONDUCT RULES

As a general comment, we strongly encourage the CSA to provide for registration and business conduct exemptions that are consistent across both Proposed NI 93-101 and Proposed NI 93-102. Exemptions from the registration requirement should give rise to corresponding exemptions from business conduct requirements. For example, while Proposed NI 93-102 provides for a *de minimis* exemption from certain registration requirements, it is unclear why there is no corresponding business conduct exception under Proposed NI 93-101. In our view, the misalignment of these exemptions will result in unnecessary market confusion and, as such, we strongly support the implementation of harmonized exemptions across both Proposed Instruments.

In addition, we respectfully submit that, failing a much more streamlined treatment of the business conduct requirements and exemptions across Proposed NI 93-101 and NI 31-103, the compliance burden for firms registered to engage in trading or advisory activities in both securities and OTC derivatives will be rendered unreasonably more complex for no clear marginal benefit in terms of investor or market protection. In our view, the focus for market participants should be to apply core business conduct requirements across their businesses, without having to devote valuable compliance resources to implementing technical variations in the business conduct requirements applicable under both Proposed Instruments.

In particular, we suggest that the framework for waiver of business conduct obligations with respect to EDPs should be fully aligned with the corresponding framework for waiver of business conduct requirements under NI 31-103, except where the need for a different approach is demonstrably justified. As currently proposed, Proposed NI 93-101 requires specific written waivers in areas in which such waivers are not required under NI 31-103 for apparently no clear and compelling policy reason.

8. SELF-REPORTING REQUIREMENTS

As noted above in relation to self-reporting requirements for foreign dealers and advisers under Proposed NI 93-102, sections 32 and 43 of Proposed NI 93-101 requires that a derivatives firm report to the regulator or securities regulatory authority “in a timely manner any circumstance in which the derivatives firm is not or was not in material compliance with” that Instrument or securities legislation relating to trading and advising in derivatives in the specified circumstances. In our view, this is troubling and out of step with established rules and practice in the Canadian securities industry, as well as other derivatives markets outside of Canada.

Respectfully, the CSA has not provided a compelling policy rationale to support this radical change of approach which should be the subject of much broader and extended industry consultations. Certain CSA regulators have developed their own jurisdiction-specific tools (e.g., credit for cooperation programs, whistleblowing rules and no-contest settlements) which already create an overwhelming incentive for firms to take ownership of material compliance issues and self-report them to the regulators once they have been uncovered and properly investigated. These types of measures should be expanded rather than introducing a self-reporting regime which conflicts with the existing rules in Canada and in a number of the major OTC derivatives markets globally.

Further, we respectfully question the imposition of a self-reporting requirement on foreign firms as a condition of their reliance on the substituted compliance framework in sections 38 and 43 of Proposed NI 93-101, which in our view, is also very problematic. The circumstances in which non-compliance by the foreign firm with a foreign derivatives rule could create, “in the opinion of a reasonable person”, a risk of material harm to a derivatives party in Canada or to capital markets—a standard that is already difficult in the Canadian market context—are fraught with uncertainty in the cross-border context. The foreign rules listed in Appendix A to Proposed NI 93-101 may be interpreted and enforced in very different ways in the foreign jurisdictions and these differences render this type of exercise almost impossible to conduct.

Foreign firms that are not subject to mandatory self-reporting obligations in the foreign jurisdictions in which they conduct business would become subject to significantly increased regulatory exposure, particularly in those jurisdictions which have a less remedial and more aggressive enforcement environment. The addition of this self-reporting condition to sections 38 and 43 of Proposed NI 93-101 effectively makes these exemptions unworkable and impossible to rely on, particularly for large financial groups which must carefully coordinate regulatory reporting on a global basis. In the absence of a clear and effective substituted compliance provision, many foreign firms will likely elect to simply opt out of business lines which require compliance with an additional layer of Canadian-specific business conduct requirements.

We also note that such self-reporting requirements under the Proposed Instruments may be inconsistent with a firm's home country regulatory restrictions which may prohibit the reporting or communicating of certain types of breaches of local laws. In Canada, for example, in the financial crimes area under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* as administered by the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) reporting firms are subject to specific restrictions against disclosure of suspicious transactions or activities. As a result, such legal restrictions on disclosure may be in conflict with a firm's obligations under the Proposed Instruments.

Similarly, the substituted compliance exemptions in sections 39 and 40 for derivatives dealers that are IIROC member firms or Canadian financial institutions, contingent on "prompt" self-reporting of "each instance of material non-compliance with a requirement or guideline" are equally problematic and give rise to significant concerns. The requirement to "promptly" self-report non-compliance with a guideline is particularly difficult to reconcile with the current securities regulatory framework and would create significant compliance and enforcement challenges.

In addition, the requirement under section 27 of Proposed NI 93-102 for the derivatives ultimate designated person ("**UDP**") to report instances of non-compliance with Proposed NI 93-102 or other securities legislation relating to derivatives to the applicable securities regulatory authority is also inconsistent with the existing securities compliance, self-reporting and enforcement framework. See, for example, the scope of responsibilities for the ultimate designated person under Part 5 of NI 31-103. Accordingly, we recommend that this requirement be removed from the Proposed NI 93-102.

In our view, any self-reporting requirements of the type contemplated in these Proposed Instruments should be limited to periodic (e.g., annually or quarterly) reporting to the securities regulator of regulatory actions (e.g., non-confidential enforcement actions and settlements) which are already required by the lead regulator to be disclosed (e.g., consistent with the approach taken in Multilateral Instrument 31-102).

9. SENIOR DERIVATIVES MANAGERS

Under Proposed NI 93-102, derivatives firms are required to designate a UDP, a CCO and a Chief Risk Officer. Respectfully, we are of the view that the introduction of the "senior derivatives manager" concept under Proposed NI 93-101 is superfluous and out of step with supervisory and compliance structures under existing securities legislation. Absent any compelling explanation by the CSA as to its rationale, we recommend removing it from Proposed NI 93-101.

As currently proposed, the qualifications, role and responsibilities, and the potential liabilities associated with the "senior derivatives manager" position under section 31 of Proposed NI 93-101 require further consideration and clarification, particularly as the concept applies to smaller firms with no separate business units and to foreign firms which are not subject to similar requirements in their jurisdictions of operation.

In addition, it is unclear why the senior derivatives manager should not have compliance reporting responsibilities to the firm's derivatives UDP, CCO and Chief Risk Officer given their own respective compliance-related responsibilities at the firm-wide level.

It is also not clear why functions related to the rectification and reporting of non-compliance allocated to the senior derivatives manager under subsections 31(1)(b) and 31(2)(a) and (b) and under related guidance in the Proposed 93-101CP should not be allocated to the CCO, given the need for the UDP and the CCO to oversee and monitor compliance on a consistent and firm-wide basis. The CCO, in particular, may be impeded in the performance of his or her functions if the senior derivatives manager is required to "respond, in a timely matter, to any material non-compliance" rather than to promptly escalate the matter outside the derivatives business unit and report it to the CCO. In certain situations, the senior derivatives manager may be subject to conflicts of interest (e.g., performance and revenue targets), which may lead to biased or inappropriate responses or to inadequate reporting if the senior derivatives manager is not required to engage with the CCO. Senior derivatives managers may not have the same appreciation or comprehensive view of firm-wide risk exposure, which may also lead to inadequate outcomes beyond the specific derivatives business unit.

If the CSA is unwilling to remove the senior derivatives manager requirement from the Proposed Instruments, we strongly recommend that, at a minimum, the requirement to appoint a senior derivatives manager should not apply to firms that restrict their derivatives business to EDPs or to foreign firms that are already subject to similar requirements on an outcomes basis.

10. HARMONIZATION ACROSS INSTRUMENTS

As a general but significant comment, we would suggest that the CSA implement a single set of definitions applicable to both Proposed NI 93-102 and Proposed NI 93-101, as well as harmonize definitions and concepts across other relevant regulatory instruments. This would facilitate a more coherent and workable OTC derivatives regulatory framework. The absence of consistency with other regulatory definitions creates material compliance challenges and, in our view, there is no compelling policy or regulatory reason for these minor technical variations. They add unnecessarily to the compliance burden and associated compliance costs of market participants.

For example, we respectfully question how the definition of "transaction" under the Proposed Instruments is intended to relate to similar definitions under other securities legislation and rules. The definition of "trade" under section 1 of the *Securities Act* (Ontario) includes "a novation of a derivative, other than a novation with a clearing agency", whereas the definitions under the Proposed Instruments refer to "a novation of a derivative, other than a novation with a *'qualifying'* clearing agency". The definition also differs from the definitions of "transaction" for purposes of provincial trade reporting rules which refer to "entering into, assigning, selling or otherwise acquiring or disposing of a derivative or the novation of a derivative". Further, certain requirements of the Proposed Instruments make reference to persons "transacting" in derivatives while others refer to "trading" in derivatives.

Notwithstanding the related guidance in Proposed 93-102CP and Proposed 93-101CP, we urge the CSA to take this opportunity to harmonize the definitions of "Canadian financial institution", "managed account", the definitions used for the purposes of categorizing an EDP and other definitions across all relevant national instruments including, specifically, NI 31-103, National Instrument 45-106 *Prospectus Exemptions*, and the Proposed NI 93-101 and Proposed NI 93-102.

11. ADDITIONAL RECOMMENDATIONS

Implementation and Transition

We respectfully submit that the revised draft of the Proposed Instruments should provide for an extended period of transition (a minimum of two years from the effective date) and broad grandfathering provisions for counterparty qualification requirements (e.g., under the QDA and existing provincial blanket orders), and individual proficiency and experience requirements. This would allow derivatives market participants adequate time to develop and implement internal policies and compliance procedures and update compliance systems.

Compliance and Risk Management

In connection with the requirements for determining the value of the derivative and the process of dispute resolution under sections 41 and 42, respectively, of Proposed NI 93-102, we respectfully suggest that the CSA consider including a requirement that firms take into consideration prevailing market practices in the global derivatives jurisdictions.

We also note that the requirement in Proposed NI 93-102, section 42(4) for a firm to report to the regulator a dispute that has not been resolved within 30 days of reporting the dispute to its board of directors is not consistent with the existing compliance and dispute resolution framework outside of Quebec. Absent a compelling policy rationale for this requirement, we respectfully recommend that this requirement be deleted.

In respect of the requirement for firms to maintain procedures for portfolio reconciliation and portfolio compression exercises under sections 44 and 45 of Proposed NI 93-102, respectively, we would suggest that Proposed NI 93-102 provide a clear registration exemption for third party portfolio compression and related services and other non-dealer service providers that facilitate these risk mitigation procedures.

Pre-transaction Disclosure

The pre-transaction disclosure requirements set out in section 19 of Proposed NI 93-101 may not be entirely aligned with disclosure practices in the OTC derivatives industry. We think that these requirements should be eliminated. In the alternative, if required, we recommend that they be incorporated into the relationship disclosure information delivery requirements.

Non-targeted Advising

We are of the view that the definition of “financial or other interest” in subsection 57(1) of Proposed NI 93-101 is too vague and should be reconsidered. In particular, sub-clauses (d) (a financial arrangement in relation to the derivative or underlying interest) and (e) (any other interest that relates to the transaction) are very broad and may present unnecessary compliance issues/obstacles for advisers.

* * * * *

Thank you for the opportunity to comment on the Proposed Instruments. Please do not hesitate to contact any of the undersigned if you have any questions in this regard.

Yours truly,

Alix d’Anglejan-Chatillon
Ken Ottenbreit
Sterling Dietze
Ramandeep Grewal
Margaret Grottenthaler
Philip Henderson