ISDA Safe, Efficient Markets

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

c/o

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Dear Sirs/Mesdames:

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

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] has been actively engaged for many years with providing input on regulatory reforms impacting derivatives in major jurisdictions globally, including Canada. ISDA appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") in response to the

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

notice and request for comments (the "**Notice**") regarding the above-noted Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (the "**Proposed Instrument**") and Companion Policy ("**CP**" and, together with the Proposed Instrument, the "**Proposed Business Conduct Rule**"). In this letter, ISDA wishes to outline areas that we believe require further scrutiny and revision, in addition to our responses to the specific questions posed by the CSA in the Notice, which are included in Schedule A. This comment letter and ISDA's comment letter on the Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed Registration Instrument"**) and Proposed Companion Policy 93-102CP *Derivatives: Registration* (collectively, the "**Proposed Registration Rule**") ("**Proposed Registration Rule Comment Letter**") should be read together given the many overlapping issues in the two instruments.

1. General Observations

ISDA commented on the previous version of the Proposed Business Conduct Rule in 2017[2] (the "**2017 Comment Letter**"). While we appreciate that some of ISDA's previous comments were accepted, ISDA is concerned that certain comments were not accepted by the CSA, considering the new requirements that have since been proposed by the CSA in the Proposed Registration Rule. In this letter we wish to reiterate and reinforce select material comments from the 2017 Comment Letter that were not accepted by the CSA, but that we believe are essential to be reflected in a final version of the Proposed Business Conduct Rule. We are also submitting comments in respect of the changes to the previous version of the rule.

ISDA believes that the following issues, if unaddressed, could significantly reduce liquidity in the relatively small Canadian OTC derivatives market due to the unduly onerous compliance requirements and asymmetrical interjurisdictional rules.

2. Exemptions for Foreign Dealers and Advisers

Compliance Reporting Condition

ISDA and its members are very concerned by the proposed addition of a new condition to the exemptions for foreign derivatives dealers and advisers in Sections 38 and 43 of the Proposed Instrument. As proposed, firms that rely upon these exemptions will be required to report to Canadian securities regulators in a timely manner the following:

> *any circumstance in which, with respect to the derivatives activities of the derivatives firm, the derivatives firm is not or was not in material compliance with the laws of the foreign jurisdiction or securities legislation relating to trading in derivatives that is listed in Appendix A and if any of the following applies:*

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[2] The ISDA comment letter on the 2017 version of 93-101 can be found online at http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_2017901_93-101_katherined.pdf

(i) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to a derivatives party located in Canada;

(ii) the non-compliance creates, in the opinion of a reasonable person, a risk of material harm to capital markets;

(iii) the non-compliance is part of a pattern of non-compliance.

This reporting requirement would greatly exceed the regulatory reporting requirements that apply to most foreign firms in their home jurisdictions. It would also greatly exceed all current reporting requirements for both registered securities firms and exempt securities firms in Canada. Currently, for example, registered dealers and advisers, and certain non-resident investment fund managers that rely on registration exemptions in the provinces of Ontario, Quebec and Manitoba, must file "Notices of Regulatory Action", which generally require reporting of (a) settlements with financial regulators, (b) ongoing investigations of financial regulators and (c) sanctions, penalties or orders imposed by financial regulators.

ISDA believes that the proposed exemptions for foreign dealers and advisers should not include any regulatory reporting conditions, given that any firm that relies on the exemptions will be required to report on regulatory matters to their home jurisdiction regulator. However, if regulatory reporting is made a condition of the foreign dealer and adviser exemptions in the Proposed Instrument, the regulatory reporting must, at minimum, be consistent with a firm's reporting obligations to its home jurisdiction regulator. ISDA therefore strongly encourages the CSA Derivatives Committee to re-consider the proposed compliance reporting condition. If reporting is necessary, firms should be required to report only regulatory actions, as is the case for non-resident investment fund managers that report on Form 32-102F2. Furthermore, the timing of reporting of regulatory actions should be consistent with the timing of reporting required in a firm's home jurisdiction. Accelerated reporting of global regulatory actions to securities regulators Canada is not workable for large multinational firms that must coordinate regulatory reporting on a global scale. ISDA would welcome the opportunity to have further discussions with the CSA Derivatives Committee on the proposed regulatory reporting conditions for foreign dealers and advisers. Absent a reconsideration of the reporting conditions currently Sections 38 and 43 of the Proposed Instrument, there will be a risk that this requirement will deter non-Canadian firms from participating in the Canadian markets, an outcome that ISDA and its members wish to avoid.

Eligibility for Substituted Compliance

As noted previously, the foreign derivative dealers and adviser exemptions in the Proposed Business Conduct Rule are predicated on foreign dealers and advisers being subject to a similar regulatory regime in their home jurisdiction. However, in this second iteration of the Proposed Business Conduct Rule, these jurisdictions and regimes have not yet been identified. The CSA has indicated that the proposed jurisdictions and regimes will be published for comment before the end of 2018. Should the CSA keep the approach to substituted compliance for foreign derivatives dealers and advisers that is currently taken

in the Proposed Business Conduct Rule then it is essential that the CSA publish for public comment the list of available substituted compliance jurisdictions and laws, along with re-publishing the Proposed Instrument and any applicable revisions in advance of finalizing both the Proposed Business Conduct Rule and the Proposed Registration Rule. In that future publication, ISDA requests that the CSA clarify that exemptions for foreign dealers and advisers will also extend to Canadian branches of foreign dealers and advisers that are subject to a similar regulatory regime in their home jurisdiction.

ISDA also requests that the CSA provide clarity and reassurance that the foreign regulatory regimes and rules that will suffice for an exemption from the Proposed Business Conduct Rule will be the same in all respects as the foreign regulatory regimes and rules that will suffice for an exemption from the registration requirements in the Proposed Registration Rule. Otherwise, foreign firms may be left in an untenable position where they are exempt from registration but not business conduct, or *vice versa*, and may need to separately evaluate ability to rely on exemptions under each rule. For instance, it would cause significant market disruption if the regulatory regime of the U.S. Commodity Futures Trading Commission is not identified for substituted compliance for both the Proposed Business Conduct Rule and the Proposed Registration Rule. If the CSA resolves to list substituted compliance jurisdictions in an appendix to each of the Proposed Registration Rule and Proposed Business Conduct Rule ISDA urges the CSA to harmonize the jurisdictions and availability of exemptions applicable to those jurisdictions on each list.

Furthermore, as discussed in the Proposed Registration Rule Comment Letter, a foreign derivatives dealer should not need to apply to any securities regulator or securities regulatory authority in Canada for exemptive or discretionary relief from the Proposed Business Conduct Rule when such an entity, by way of an exclusion or exemption, is not required to make any similar application in its home jurisdiction.

Notably, the U.S. CFTC has recently signaled its intention to pursue the utilization of a flexible, outcomes-based approach to substituted compliance, and, particularly for swaps execution and cross-border activities of swap dealers, to recommit to deference processes (such as equivalence and substituted compliance) to increase regulatory coordination and reduce market balkanization. Chairman Giancarlo of the CFTC has recently further noted that:

> "When it comes to swaps reforms that do involve global systemic risk transfer [i.e. business conduct and registration], we must pursue multilateral coordination to achieve high levels of comparability on the basis of comity but not on the basis of what is identical. The alternative is a world in which every regulator asserts global jurisdiction over swaps trading abroad by its home-domiciled institutions. This leads to overlapping, duplicative and possibly conflicting regulations that stymie global economic recovery…It is a path that is essential for the growth of not only

> U.S. markets, but also those of important global partners, such as Singapore [which has a share of the global derivatives market larger than that of Canada]."[3]

Given the CFTC's drive to build consensus among the regulatory community in a global, coordinated manner, ISDA strongly supports the CSA taking a broad approach to assessing substituted compliance while prioritizing an avoidance of disruption of cross border trade flows. Rather than granularly mapping of analogous legal provisions across multiple jurisdictions, we support a comprehensive approach whereby any jurisdiction that is a member of IOSCO would be an appropriate substituted compliance regime. From a policy perspective, ISDA's view is that there is no justification to limiting foreign dealers to registered dealers of only certain IOSCO jurisdictions.

3. Other Business Conduct Exemptions

a. Harmonization of the exemptions provided in the Proposed Registration Rule and Proposed Business Conduct Rule

Unlike in the Proposed Registration Rule, there is no *de minimis* exemption proposed from the derivatives dealer business conduct requirements. With respect, it is unclear why a firm may be entitled to rely on a dealer registration exemption in the Proposed Registration Rule but not an exemption from the application of business conduct requirements. ISDA believes that the dealer business conduct requirements should only apply to dealers who are subject to registration requirements and accordingly the Proposed Business Conduct Rule should have a *de minimis* exemption identical to the exemption in the Proposed Registration Rule.

ISDA further recommends that, in order to ensure consistency with the Proposed Registration Rule, which provides for a carve-out for crown corporations in Subsection 5(c), the Proposed Business Conduct Rule should also provide an exemption for crown corporations.

In ISDA's view, asymmetrical exemptions in the Proposed Business Conduct Rule and Proposed Registration Rule would result in market uncertainty and confusion in an already complex derivatives regime. We therefore strongly encourage the CSA to harmonize the exemptions.

b. Exemption for Trades with a Canadian Derivatives Dealer

Similar to the Proposed Registration Rule, ISDA is concerned that the CSA has not proposed a business conduct exemption for a derivatives party that trades with a Canadian derivatives dealer (for purposes of this section, either a registered derivatives dealer or a regulated financial institution exempt from registration under Section 35.1 of the *Securities Act* (Ontario). The registration exemption in Section 8.5 of NI 31-103 serves an important

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[3] Remarks by Chairman J. Christopher Giancarlo at the ISDA Industry and Regulators Forum, Singapore, September 12, 2018

function in Canadian securities markets by supporting robust trading and liquidity within Canada and cross-border by enabling unregistered firms, including foreign dealers, to trade securities with Canadian registered investment dealers without the unregistered firm being subject to a Canadian registration requirement. Under the Proposed Registration Rule and Business Conduct Rule, however, a trade between an unregistered firm and a Canadian derivatives dealer could potentially subject the unregistered firm to registration or the need to comply with business conduct obligations, or at minimum the need to conduct an analysis of whether registration and business conduct requirements apply. This may cause significant harm to liquidity in Canadian derivatives markets without any corresponding benefit of protection to Canadian investors or market participants. So long as one party is a Canadian derivatives dealer it serves no purpose for both counterparties to be registered or subject to the requirements of the Proposed Business Conduct Rule. Foreign dealers may be unwilling to perform the required analysis to determine their obligations under the Proposed Business Conduct Rule and avoid transacting with Canadian counterparties unless they are guided to a specific waiver or exemption. ISDA therefore proposes that an exemption for derivatives transactions conducted with a Canadian derivatives dealer be included in the Proposed Registration Rule and the Proposed Business Conduct Rule.

4. Definition of "eligible derivatives party"

ISDA remains concerned that the definition of "eligible derivatives party" ("**EDP**") is cumbersome and mostly duplicates other established Canadian client definitions, such as "permitted client", but with slightly higher financial thresholds. As we observe in the Proposed Registration Rule Comment Letter, notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of EDP should include all the persons that qualify as "permitted clients" under NI 31-103.

ISDA appreciates that the CSA has included a category of "commercial hedgers" in paragraph (n) of the definition of EDP. However, as discussed further in the Proposed Registration Rule Comment Letter, absent a clear policy justification for excluding mid-market entities from access to OTC derivatives transactions as qualified EDPs, we believe that either (a) no minimum net asset threshold or (b) a lower net asset threshold of $1 million in net assets at (n) (ii) would be more appropriate for smaller businesses and will continue to result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSAs policy objectives.

As detailed in the Proposed Registration Rule Comment Letter, while we acknowledge that the CSA has taken steps to ensure that commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies, we have concerns with the high threshold for a commercial hedger category of EDP at paragraph (n). There is no minimum financial threshold for hedgers under local blanket orders and exemptions, including the *Derivatives Act* (Quebec), and there is a much lower Eligible Contract Participant ("**ECP**") threshold in the U.S. ISDA respectfully requests that the CSA provide evidence that the exemptions for trading with hedgers that are currently used by OTC derivatives dealers in Canada today are giving rise to an undue risk of harm to hedgers due to their being no minimum financial threshold to

being a hedger. We expect that introducing a threshold to the commercial hedger exemption will disqualify market participants who may need (and under the current rules, currently have) access to opportunities for effective pricing, as many dealers will opt to only trade with EDPs. Introducing the proposed financial thresholds will almost certainly disrupt current market practice and unfairly impinge access for certain market participants. Respectfully, securities regulatory authorities should not be increasing access thresholds absent clear evidence of harm resulting from the existing rules.

As a final observation on the EDP definition, members of ISDA strongly encourage the CSA to consider that there is a need to align the EDP definition with the "eligible contract participant" definition under the U.S. Commodity Exchange Act. For example, governmental, multinational or supranational government entities, including multilateral development banks and central banks, and entities controlled by, owned by, or wholly guaranteed by the foregoing, qualify as ECPs in the U.S. However, only Canadian and foreign governments and their agencies are considered EDPs under the Proposed Instrument and Proposed Registration Rule. Further, commercial hedgers with over $1 million in net assets qualify as ECPs in the U.S., but must have over $10 million in net assets in order to qualify as EDPs under the Proposed Instrument and Proposed Registration Rule. Harmonizing cross-border rules reduces the regulatory burden for derivatives firms and derivatives market participants. Any deviation to commonly used definitions without a related policy justification will cause a disproportionate compliance burden on Canadian derivatives market participants.

5. Derivatives Party Agreement

Section 33 of the Proposed Instrument requires that all derivatives firms enter into an agreement with a derivatives party before transacting in a derivative with, for or on behalf of that derivatives party. This is not market standard for foreign exchange transactions ("**FX**") in the Canadian market, where firms typically trade using a confirmation, including a SWIFT confirmation, rather than a deemed ISDA Master Agreement (a "**Deemed ISDA**") unless the parties are subject to U.S. Dodd-Frank Act requirements. This provision will necessitate a Canadian-specific ISDA protocol to incorporate a Deemed ISDA into trades where there is no ISDA Master Agreement. Our concern is that, unlike the U.S., foreign dealers will not be willing to adhere to a Canadian specific protocol and will simply trade with other market participants instead. No other jurisdiction with a derivatives market of a comparable size (e.g. Australia) has an ISDA protocol. FX should therefore be excluded from Section 33 of the Proposed Instrument. Alternatively, the CSA could allow firms to comply with the Global Foreign Exchange Committee's FX Global Code of Conduct in lieu of Canadian specific business conduct rules. Given the CSA's concern that the FX code of conduct is not binding, compliance with the FX code of conduct could be included as a condition for substituted compliance for FX so that it would be enforceable by the CSA.

6. Other Issues

Clarity regarding application of business conduct rules to derivatives firms

ISDA remains concerned about the lack of clarity as to whether the Proposed Business Conduct Rule will apply to all trading activity of a derivatives dealer or derivatives adviser if only a portion of the derivatives dealer or adviser's business involves Canadian counterparties. For example, under the OSFI margin guidelines for non-centrally cleared derivatives, OSFI instructs that Canadian covered entities may comply with the rules of a foreign jurisdiction when trading with foreign counterparties, so long as the rules of the foreign jurisdiction are comparable to the OSFI margin requirements. We recommend that the CSA provide similar guidance on the scope of the Proposed Business Conduct Rules.

Self-reporting requirements

The requirement to self-report certain circumstances of material non-compliance to the CSA is not limited to foreign dealers and advisers, as discussed above. All firms subject to the Proposed Business Conduct Rule will be subject to a self-reporting obligation pursuant to Section 32 of the Proposed Instrument, including (in some circumstances) IIROC dealers (pursuant to Section 39(b) of the Proposed Instrument) and Canadian financial institutions (pursuant to Section 40(b) of the Proposed Instrument). It is not clear to ISDA and its membership whether a new self-reporting requirement layer is necessary given that IIROC dealers and Canadian banks already have significant self-reporting requirements.

The reporting requirements in Section 32 of the Proposed Instrument, which are duplicative of the reporting requirements in Section 27(3)(d) of the Proposed Registration Instrument, are not appropriate. First, there is unnecessary confusion and complexity that results from overlapping compliance requirements in the two instruments. Second, while ISDA strongly supports that derivatives firms must identify and resolve compliance issues that may arise, and further that derivatives firms should be encouraged to self-report material violations of securities legislation, ISDA disagrees with the proposed requirement for derivatives firms to self-report material non-compliance, and to do so on a "timely basis". ISDA believes that imposing a self-reporting requirement greatly exceeds the scope of the Proposed Business Conduct and the Proposed Registration Rule, particularly given that there are no similar self-reporting requirements for other market participants under applicable provincial securities law. The CSA has not provided any justification as to why derivatives firms registered in Canada should be held to a significantly different standard than securities firms registered in Canada or derivatives firms under similar regulatory regimes outside of Canada. In the absence of any such justification, ISDA respectfully requests that the CSA re-consider the self-reporting requirement, or significantly alter the requirement to focus on periodic reporting (annually or quarterly) of regulatory actions (investigations, settlements and orders involving the derivatives firm and a financial regulator).

Registration triggers for acting as a derivatives dealer or adviser

ISDA acknowledges the addition of a more robust description of market making activity in the list of business trigger factors used to determine whether an entity is acting as a derivatives dealer. As we have previously commented to the CSA, ISDA prefers that market making be the only factor to determine whether an entity is acting as a derivatives dealer. However, if the CSA are not willing to limit the scope of derivatives dealing to

market making, in the alternative we continue to recommend that the proposed definitions of derivatives dealer and derivatives adviser be revised to more precisely and clearly articulate whether the activities of a derivatives party bring them into the scope of these definitions.

In particular, the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" is problematic and difficult or impossible to apply in practice, particularly for buy-side institutions. As discussed in greater detail in the Proposed Registration Rule Comment Letter, frequent derivatives trading activity, in the absence of the other business purpose factors, should not constitute dealing activities. For example, large buy-side institutions may engage in various types of OTC derivatives transactions with repetition, regularity or continuity. Examples include the hedging of foreign currencies or the frequent trading of OTC equity derivatives. These transactions are not dealing activity and may not squarely fit within the registration exemption for end users in Section 37 of the Proposed Instrument. We also note that this factor is not included in the similar list of factors to identify a derivatives dealer for trade reporting purposes in the companion policy to MI 96-101 *Trade Repositories and Derivatives Data Reporting*. We see no reason why this factor could be relevant to identify a derivatives dealer for business conduct and registration but not trade reporting. We therefore recommend that the CSA remove from the CP the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" as a business trigger or, in the alternative, modify the factor as "directly or indirectly carrying on market-making activity with repetition, regularity or continuity".

Individual responsibility when dealing or advising certain derivative parties

Various requirements, such as suitability in Section 12 of the Proposed Instrument and referral arrangements in Section 13 of the Proposed Instrument, apply to both a derivatives firm or an individual acting on behalf of a derivatives firm. Individual responsibilities could theoretically encompass individuals who are not involved in making the decision to transact (for example, operations, documentation, or legal personnel). The CSA should therefore clarify that individual responsibility should be limited to counterparty-facing individuals (i.e. salespersons, traders and advisers on derivative transactions) or, more precisely, individuals who are required to register as a derivatives dealing representative or derivatives advising representative under the Proposed Registration Rule.

Safe harbour for suitability requirements

In addition to the current exemptions from the suitability requirements under Section 12 of the Proposed Instrument when dealing with an EDP, ISDA believe that a safe harbour mirroring that of Regulation 23.434(b) should be included in the suitability requirements under Section 12 of the Proposed Instrument in cases when the counterparty is not an EDP. Regulation 23.434(b) of the U.S. Commodity Futures Trading Commission contains a safe harbour provision to a dealer's obligation to have a reasonable basis to believe that the recommended derivative is suitable for the counterparty. The safe harbour provision is subject to three pre-conditions in transactions with non-governmental counterparties: (a)

the dealer must reasonably determine, via a written representation from the counterparty or otherwise, that the counterparty is capable of independently evaluating investment risks with regard to the relevant derivative or trading strategy; (b) the counterparty represents in writing that it is exercising independent judgment in evaluating the recommendations of the dealer with regard to the relevant derivative or trading strategy and (c) the dealer discloses in writing that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of the derivative or trading strategy.

Responsibilities of senior derivatives managers

ISDA appreciates the revisions made to the responsibilities of senior derivatives managers in the Proposed Business Conduct Rule to better reflect existing compliance structures at derivatives firms. However, ISDA continues to note that the proposed senior manager regime may risk deterring foreign dealers and advisers from fully participating in the Canadian market given that it is unique globally as a derivatives-specific regime, and add unnecessary legal and compliance burden to both foreign and domestic dealers and advisers. If the CSA is unwilling to remove the proposed senior manager regime, ISDA recommends that the regime should not apply if a derivatives firm only deals with, or advises, EDPs. Further, with respect to non-EDPs, substituted compliance should be provided on an outcomes basis for dealers subject to prudential or similar requirements that provide for comprehensive compliance and accountability consistent with existing global derivatives regulations.

Books and Records for Foreign Derivatives Dealers and Advisers

ISDA also wishes to propose a wording change to Section 38(3)(d) of the Proposed Instrument to address the legal restrictions that may apply to some Canadian and non-Canadian firms if asked to provide information to the CSA:

> (d) <u>subject to any blocking, privacy or secrecy laws applicable to the derivatives dealer, and, where customary, giving preference to the cooperation between home and host country regulatory authority regarding books and records access</u>, the derivatives dealer undertakes to the regulator or the securities regulatory authority to provide the regulator or the securities regulatory authority with prompt access to its books and records upon request.

We note that the same wording change should apply to Section 38(3)(d) of the Proposed Instrument and any other sections of the proposed rule that require that materials be provided to a securities regulatory authority. We further note that access to books and records should be limited to books and records relating to transactions with Canadian counterparties.

7. <u>Effective date and scope of Proposed Business Conduct Rule</u>

The requirements in the Proposed Registration Rule and the Proposed Business Conduct Rule should come into effect concurrently, with sufficient time allowed to implement appropriate policies and procedures, train relevant personnel, receive any required

representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation. We recommend that the CSA provide at least a three-year implementation period, and an implementation date towards compliance-heavy periods at both the beginning and end of the year. A three-year implementation period will allow individuals to qualify under proficiency requirements under the Proposed Registration Rule and will allow both the Proposed Registration Rule and the Proposed Business Conduct Rule to come into force simultaneously.

Multiple members of ISDA have also emphasized the importance of CSA publishing the entire Proposed Business Conduct Rule including the proposed appendices for comment prior to its finalization. Without sufficient knowledge over the scope of substituted compliance, market participants will find it impossible to assess the impact of the Proposed Business Conduct Rule.

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ISDA and its member would like to reiterate our appreciation to the CSA for the opportunity to provide feedback on the Proposed Business Conduct Rule. We are happy to discuss our responses and to provide any additional information that may be helpful.

Thank you for your consideration of these important issues to market participants. Please contact the undersigned if you have any questions or concerns.

Yours very truly,

Name: Katherine Darras
Title: General Counsel

Schedule A:

Specific requests for comment from the CSA

Comments

In addition to your comments on all aspects of the Proposed Instrument, the CSA also seek specific feedback on the following questions:

1) Definition of "affiliated entity"

The Instrument defines "affiliated entity" on the basis of "control", and sets out certain tests for "control". In the context of other rules relating to OTC derivatives, we are also considering a definition of "affiliated entity" that is based on accounting concepts of "consolidation" (a proposed version of the definition is included in Annex IV). Please provide any comments you may have on (i) the definition in the Instrument, (ii) the definition in Annex IV, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

Please see Proposed Registration Rule Comment Letter for further comments on the proposed definition. As ISDA has noted in previous comment letters, until such time as the CSA addresses the definition of affiliate more broadly, ISDA believes it is important that the Proposed Business Conduct Rule not create additional uncertainty as to how the term affiliate is to be applied. It would be problematic if a different definition of affiliate were applied in different derivatives rules, such as registration, trade reporting or mandatory clearing rules, and similar securities rules without a comprehensive consultation. We request that the CSA make efforts to avoid the potential for additional uncertainty by avoiding a change to the definition of "affiliate" specifically for the Proposed Business Conduct Rule. ISDA continues to support a separate consultation to understand and improve the definition of affiliate more generally throughout Canadian derivatives and securities regulations.

2) Definition of "eligible derivatives party"

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.

Please see ISDA's comment letter responding to the Proposed Registration Rule (reproduced below for reference).

ISDA appreciates that the CSA has included a category of "commercial hedgers" in paragraph (n) of the definition of EDP. We expect that the inclusion of a commercial hedger category will help mitigate the risk that Canadian commercial hedgers will be unduly burdened by the introduction of the Proposed Registration Rule and Proposed Business Conduct Rule. However, ISDA continues to have other concerns with the EDP definition.

While we acknowledge that the CSA has taken steps to ensure that commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies, we have concerns with the high threshold for a commercial hedger category of EDP at paragraph (n). As noted in Section 4 of this letter, currently there is no hedger threshold in most of Canada, and a much lower Eligible Contract Participant ("ECP") threshold in the U.S. Members of ISDA urge the CSA to delete the financial threshold for commercial hedgers and, failing that, align the EDP and ECP definitions.

In our view, sophisticated entities with less than $10 million in net assets should be eligible to hedge using derivatives as EDPs. At a threshold of $10 million in net assets, it is likely many mid-market entities would not be able to satisfy the asset threshold to qualify as EDPs and would therefore be unfairly prevented from participating in certain derivatives transactions with dealers that opt only to trade with derivatives parties that qualify as EDPs. Absent a clear policy justification for excluding mid-market entities from access to OTC derivatives transactions as qualified EDPs, we believe that either no minimum net asset threshold for commercial hedgers or a lower net asset threshold of $1 million in net assets would be more appropriate for these smaller businesses and will result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSAs policy objectives. Further, many subsidiaries of large multinational corporations, including special purpose entities, may not satisfy the $10 million net asset requirement, which is inconsistent with the ECP requirements. Such subsidiaries are centrally managed by corporate treasury and are generally using derivatives to hedge or mitigate commercial risks. Many such special purpose entities are also intentionally structured to minimize net assets. A lower net asset threshold would help to mitigate these concerns.

With respect to paragraphs (m), (n) and (o) of the definition specifically, as noted in past comments to the CSA, we believe that the requirement for written representations regarding requisite knowledge and experience requirement is unnecessary and may have the unintended effect of disadvantaging sophisticated derivatives parties that currently benefit from participation in the derivatives market. We believe that financial thresholds, which have been widely adopted as the objective standard to assess sophistication in Canadian securities regulation and U.S. securities and derivatives regulation, are appropriate and sufficient to identify derivatives parties who are not in need of extra protections. Whether individuals or not, persons who have sufficient financial resources to purchase professional advice (where necessary or appropriate) or are otherwise financially sophisticated parties can independently assess their risks and make their own judgments regarding their derivatives transactions.

ISDA also remains concerned that, in addition to obtaining written knowledge representations from a derivatives party, the CP would require firms to assess the reasonableness of relying on a derivative party's written representations regarding their knowledge and experience. As we have previously expressed to the CSA, this creates unnecessary ambiguity around the determination of a derivatives party's EDP status. If the requirement to obtain such representations is retained by the CSA in the final definition of EDP in both the Proposed Registration Rule and Proposed Business Conduct Rule, derivatives firms should be able to rely on those representations absent having any basis or grounds to believe the representations are false. It is unduly burdensome to impose an affirmative obligation on dealers and advisers to assess the reasonableness of representations from counterparties who satisfy the financial thresholds in paragraphs (m), (n) or (o) of the EDP definition.

Requiring written representations regarding requisite knowledge and experience from derivatives parties and requiring a subjective assessment of those written representations by derivatives firms will impose a significant burden on derivatives firms without any meaningful benefit to derivatives parties. The additional cost and compliance burden may seem minor in isolation, but when combined with derivatives trade reporting requirements, mandatory clearing requirements, margin requirements for uncleared derivatives trades and requirements that may apply under securities law, the cumulative impact on derivatives firms to obtain another written representation from derivatives parties and assess the reasonableness of that representation is unwarranted and onerous. If the CSA has an informed concern, based on an objective assessment of current Canadian derivatives markets, that there is a meaningful population of Canadian persons who meet the financial thresholds in paragraphs (m), (n) or (o) but do not have the requisite knowledge and experience to transact in derivatives, that concern should be specifically explained in future rule proposals subject to public comment so that derivatives firms can consider and respond with proposed solutions to mitigate or address that concern.

ISDA also remains concerned that the EDP definition mostly duplicates other established Canadian definitions, such as "permitted client" in NI 31-103. As ISDA has observed in past comments to the CSA, notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of EDP should include all the persons that qualify as "permitted clients" under NI 31-103. We have previously indicated that the derivatives industry will face an enormous compliance burden if existing disclosures and representations by clients regarding their "permitted client" status cannot be leveraged to determine EDP status under the Proposed Registration Rule and Proposed Business Conduct Rule for any new trades that may be undertaken one year after the Proposed Instrument comes into force. We do not believe that this compliance burden is warranted. If an entity is eligible to participate in the exempt securities market, it stands to reason that it does not need the full set of protections contemplated under the Proposed Business Conduct Rule for non-EDPs. In addition to the adequate investor protection mechanisms in place for permitted clients, it should be re-emphasized that, given that derivatives dealers typically have an ongoing credit relationship with their derivatives counterparties, derivatives dealers indirectly address investor protection concerns as dealers have an extra incentive to appropriately assess and manage risk with their derivatives counterparties.

We have previously observed that, given the existing definitions of "accredited investor" for prospectus disclosures and "permitted client" under NI 31-103, a different definition for EDPs would result in market participants trading prospectus exempt securities and derivatives having to analyze and give representations with respect to three separate definitions. Also, for derivatives firms that are regulated in other jurisdictions, it is commonly the case that the derivatives firm must confirm whether the derivatives party is an "eligible contract participant" as defined in the CEA.

Participants in the global derivatives markets have incurred significant costs in recent years overhauling their onboarding procedures and reference data systems to classify counterparties under the many different rule sets and related definitions implemented as part of the G20 reform agenda (including, most recently, in connection with new rules for margin for uncleared derivatives). Unless dealers and advisers may rely on existing representations and disclosures regarding their clients' "permitted client" and "eligible contract participant" status, a large-scale outreach effort will be required to determine the EDP status of all counterparties to comply with

the Proposed Registration Rule. We are not aware of any policy reason that would justify imposing such a significant compliance burden on the derivatives markets in Canada. We therefore request that additional paragraphs be added to the definition of EDP to deem any derivatives party that is (i) a "permitted client" as defined in NI 31-103 or (ii) an "eligible contract participant" as defined in the CEA to also be an EDP.

3) Anonymous transactions executed on a derivatives trading facility

We are considering whether the exemption in section 41 should be expanded in respect of other requirements in this Instrument. Is it appropriate to expand this exemption?

ISDA welcomes the new exemption proposed by the CSA from certain business conduct requirements if a derivative is traded on a derivatives trading facility (such as a SEF or MTF). However, ISDA does not believe that the exemption should be conditioned on the derivative being cleared. The exemption should apply to derivatives traded on a facility ***or*** cleared (including in respect of the "alpha" trade). This is consistent with the important policy of promoting both derivatives clearing and trade execution on multilateral venues and is consistent with the CFTC's similar exclusion from its business conduct rules. Also, given that derivatives trading facilities and clearing houses have their own rules and compliance requirements that derivatives firms must abide by, ISDA requests that the CSA expand the scope of the exemption to create a complete exemption from Proposed Business Conduct Rule for derivatives traded on derivatives trading facilities, rather than limiting the exemption to the "know your derivatives party" and "content and delivery of transaction information" requirements. ISDA's recommendation that there be an exemption for a derivatives firm from all business conduct requirements in respect of derivatives traded on a derivatives trading facility mirrors the approach taken in most international jurisdictions. ISDA encourages the CSA to consider that there is a need to align Canadian exemptions for transactions executed on a derivatives trading facility with those applied in the U.S. Failure to do so may risk discouraging trading on derivatives trading facilities such as SEFs in contrary to the principles underlying Canada's G20 commitments.

If the CSA is unwilling to expand the scope of the exemption to include all business conduct requirements, we continue to recommend that the existing exemption be expanded to include an exemption from the conflicts of interest requirements in Section 9 of the Proposed Instrument for all anonymous trades. In such instances, it will be impossible for a derivatives firm to determine whether a conflict of interest exists.

We are also considering whether a similar exemption should be available in other scenarios, including, for example:

(a) derivatives traded anonymously on a derivatives trading facility that are not cleared; and

(b) derivatives that are not traded on a derivatives trading facility but are submitted for clearing to a regulated clearing agency.

Is it appropriate to provide a similar exemption in other scenarios? Please explain your response.

Yes, it is ISDA's view that similar exemptions should be available in the scenarios listed above, and the exemption should extend to an exemption from all Proposed Business Conduct Rules. See above.

4) Handling complaints

The obligations in section 16, as proposed, do not apply if a derivatives firm is dealing with (i) an eligible derivatives party that is not an individual or a specified commercial hedger, or (ii) an eligible derivatives party who is an individual or a specified commercial hedger that has waived these protections. Should the obligations in section 16 be expanded towards all derivatives parties? Please explain your response.

The obligations under section 16 should not be expanded to all derivatives parties. In fact, it is ISDA's view that derivatives firms will be incentivized to manage (and indeed, do manage) complaints from all derivatives parties in an appropriate manner in order to preserve their relationships with such derivatives parties. It is likely that transactions with EDPs will be more frequent, and for larger amounts, further incentivizing derivatives firms to promptly respond to complaints. Adding a regulatory requirement for derivatives firms to build formal compliance procedures only adds a further unnecessary administrative and compliance burdens.

5) Derivatives Party Assets

We note that the requirements with respect to initial margin in sections 25 and 26 only apply to transactions with non-EDPs.

Please provide any comments you may have, including whether it would be appropriate to include, for all derivatives parties, restrictions with respect to collateral delivered to a derivatives firm (as initial margin) or adopt a model of requiring informed consent with respect to its use and investment, or some combination of the two approaches.

These provisions should be removed from the Proposed Business Conduct Rule and instead added to the Proposed National Instrument 95-401 – *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives*. If the CSA prefers to retain these provisions in the Proposed Business Conduct Rule, entities subject to equivalent requirements under prudential or other rules (for example, *OSFI Guideline E-22 on Margin Requirements for Non-Centrally Cleared Derivatives*) should benefit from substituted compliance.

ISDA further notes that the above proposed adoption of a model of requiring informed consent with respect to the use and investment of initial margin are inappropriate. Clients always have the ability to ask for segregation and to impose any other restrictions. Requiring informed consent will be administratively burdensome.

6) Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have

relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms. [Staff in British Columbia are particularly concerned about the scope of this requirement, in its current form.]

Naturally, ISDA believes that everyone should conduct business with integrity, however, it is inappropriate to include such a requirement under Section 30(1)(c)(iii) in this rule for three reasons: (i) first, it would be extremely difficult to design compliance procedures around this requirement; (ii) the CSA have already incorporated a requirement for derivatives firms, and individuals acting on behalf of derivatives firms, to act honestly and in good faith which, in ISDA's view, is a more objective and manageable standard; and (iii) similar to the reasons set out with respect to the applicability of complaint handling requirements for EDPs, individuals and derivatives firms are already incentivized to act with integrity in order to attract and maintain business and client relationships. Accordingly, it is ISDA's recommendation that the requirement set out in section 30(1)(c)(iii) be deleted as it is unnecessary and the scope and content of any such requirement is exceedingly uncertain.