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
The Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Nunavut Securities Office
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

September 17, 2018

Attention:

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comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Second Notice and Request for Comment – Proposed National Instrument 93-101 – Derivatives: Business Conduct and Proposed Companion Policy 93-101CP - Derivatives: Business Conduct

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OVERVIEW

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the second notice and request for comment published by the Canadian Securities Administrators (**CSA**) titled Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (**NI 93-101**) and Proposed Companion Policy 93-101CP - *Derivatives: Business Conduct* (the **Consultation**).

The 2017 consultation in respect of then-proposed NI 93-101 is referred to herein as the **2017 Proposal**. All other capitalized terms used in this letter but not defined in this submission have the same meaning given to them in the Consultation.

PMAC represents investment management firms registered to do business in Canada as portfolio managers. PMAC's over 250 members encompass both large and small firms managing total assets in excess of $1.8 trillion for institutional and private client portfolios.

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. PMAC consistently supports measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole.

In light of the many overlapping issues in the two instruments, this submission should be read conjunction with our contemporaneous submission on Proposed National Instrument 93-102 – *Derivatives: Registration* and Proposed Companion Policy 93-102 – *Derivatives: Registration* (**NI 93-102** or the **Registration Consultation**).

GENERAL COMMENTS

Consistent with our submission with respect to the 2017 Proposal, PMAC supports the CSA's aim to establish a robust investor protection regime that meets the International Organization of Securities Commissions' (**IOSCO**) standards with respect to over-the-counter (**OTC**) derivatives.

PMAC supports the work of the CSA to ensure that all derivatives firms remain subject to certain minimum standards in relation to their business conduct towards both investors and counterparties. We also applaud the CSA for developing a harmonized derivatives registration and business conduct regime across Canada. We believe that the establishment of a national regime is a positive step for industry, the Canadian economy, and investors.

PMAC continues to believe that the Consultation and the Registration Consultation are primarily focused on addressing policy issues arising from dealing activities and do not identify specific investor or market protection issues with respect to the activities of advisers, particularly portfolio managers, vis-à-vis derivatives.

In particular, we look to the CSA's anticipated benefits of NI 93-101 and note that, chief among them is a reduced likelihood of loss through inappropriate transactions, inappropriate sale of derivatives and market misconduct. We respectfully disagree with the CSA's assessment in the Consultation that the costs of portfolio managers complying with the proposed derivatives regime are proportionate to the benefits to the Canadian market of implementing NI 93-101 and NI 93-102, as currently drafted.

We strongly believe that the imposition of additional, prescriptive and onerous requirements on portfolio managers is not an effective or efficient solution to the CSA's stated policy concerns with respect to derivatives. For registered advisers, we continue to believe that the CSA's laudable policy objectives of creating a uniform approach and protecting participants in the OTC derivatives markets from unfair, improper and fraudulent practices can be best achieved by leveraging National Instrument 31-103 – *Registration Requirements,*

Exemptions and Ongoing Registrant Obligations (**NI 31-103**) and by providing an exemption from the derivatives registration and business conduct requirements for portfolio managers, all as more fully set out below and in our response to the Registration Consultation.

Our submission covers the following: 1) a summary of certain of PMAC's key recommendations relating to NI 93-102 and NI 93-101; 2) Consultation Feedback; and 3) responses to certain Consultation questions. The questions are identified by the number assigned to them in the Consultation and, as such, their numbering is not consecutive.

SUMMARY OF PMAC'S KEY RECOMMENDATIONS

1. **Portfolio managers should be exempt from NI 93-101 and from registration under NI 93-102.** As set out in further detail in PMAC's submission with respect to NI 93-102, registered advisers should be entirely exempt from NI 93-101 and from registration as derivatives advisers under NI 93-102, subject to being able to evidence general proficiency and implementing certain risk-management practices relating to derivatives. The rigorous proficiency standards, fiduciary duty of care owed by advisers to their investors, minimum insurance and capital requirements, and the robust, principles-based regime advisers must adhere to under NI 31-103 – coupled with a lack of any policy rationale justifying the need for separate registration and business conduct regimes for advisers - warrants an exemption for portfolio managers.

PMAC has concerns that a Canadian derivatives regime that goes beyond IOSCO's standards and that captures advisers in a way that the U.S. Commodity Futures Trading Commission does not, may have a negative impact on the Canadian derivatives market, as well as on Canadian investors. PMAC respectfully disagrees with the CSA's cost benefit analysis with respect to implementing the derivatives regime for advisers. We note that NI 93-102 and NI 93-101 would require material additional compliance resources and costs and the repapering of existing instruments, client documentation and policies and procedures, all without a demonstrated investor or market harm being addressed. PMAC's submission on NI 93-102 also explores the need for clarity on when advising in derivatives is considered to be "incidental" and sets out certain alternative exemptions for advisers in greater detail.

2. **Exemptions are required for international advisers and sub-advisers.** PMAC believes that exemptions for international advisers and sub-advisers, similar to exemptions set out in NI 31-103, should be included in NI 93-102 and NI 93-102 to ensure competitiveness and to maintain investor choice and market liquidity. PMAC is concerned that there could be unintended adverse consequences to investors and the Canadian market if existing business relationships with foreign advisers were to be interrupted as a result of the implementation of NI 93-102 and NI 93-101.

3. **Eligible Derivatives Parties**. We request that the CSA amend the definition of eligible derivatives party (**EDP**) to include any "permitted client" (as such term is defined in NI 31-103) that is not an individual. We further request that the CSA reconsider the requirement for firms to obtain a written representation from non-individual EDPs as to their "knowledge and experience" to evaluate information about derivatives. As currently drafted, the definition of EDP is not sufficiently harmonized with existing securities law concepts, nor

does it acknowledge the unnecessary burden that this new, additional definition will impose on firms and the sophisticated clients that it is intended to capture.

4. **Pre-Existing Transactions with EDPs**. PMAC requests that all derivatives transactions with "permitted clients", "accredited counterparties" or "qualified parties" that pre-exist the effective date of NI 93-101 be grandfathered. We believe that these sophisticated clients will not be prejudiced by this approach and that grandfathering all such pre-existing transactions will ease the regulatory burden without any corresponding deleterious impact to markets or EDPs.

In the alternative, should the CSA not be amenable to grandfathering these transactions, we believe that the application all of the EDP requirements should be delayed for such pre-existing transactions for a period of 4 years. We believe that this is an appropriate way to transition firms and these sophisticated clients into the derivatives business conduct requirements, while still allowing these relationships to be renewed and revised in the normal course of business.

5. **Derivatives Party Assets.** We believe that the CSA has yet to provide clarification regarding the intended application of the provisions related to segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client. While these requirements may make sense from a dealer perspective, it is unclear how they apply to a portfolio manager with a fiduciary duty not to commingle client assets.

6. **Senior derivatives manager and reporting requirements**. PMAC is pleased that the CSA made revisions to NI 93-101 to allow the senior derivatives manager to delegate his or her responsibility to submit a report to the board of directors to the firms' Chief Compliance Officer (**CCO**). However, we continue to believe that it is onerous to require firms to hire or designate an additional individual who is tasked with fulfilling substantially the same role as the firm's other registered individuals, such as the Ultimate Designated Person (**UDP**), the Chief Risk Officer (**CRO**) and the CCO. Members are concerned that requirements such as this will negatively impact the competitiveness of the Canadian market and of smaller and mid-sized Canadian firms.

7. **Coordination with other regulatory initiatives and transition matters**. PMAC's submission on NI 93-102 sets out in further detail our request that the CSA assess the impact of the proposed amendments to NI 31-103 (the **Client Focused Reforms**) on the CSA's investor protection and market efficiency concerns, prior to implementing the derivatives registration regime. Other than PMAC's request set out with respect to pre-existing transactions with EDPs, firms have approximated that a three year transition period may suffice for the implementation of many of the amendments necessitated by the derivatives regime.

CONSULTATION FEEDBACK

Amendments to NI 93-101 since the 2017 Proposal

We would like to start by thanking the CSA for their responsiveness to the comments received as a result of the 2017 Proposal that have been reflected in the Consultation. We view several of these amendments as improving the proposed derivatives business conduct regime for the benefit of investors. In particular, PMAC supports the amendment in the Consultation that allows managed account clients that are EDPs to benefit from the exemptions from certain requirements and protections applicable to other EDPs.

The amendment to NI 93-101 allowing firms to rely on certain pre-existing "permitted client", "accredited counterparty" or "qualified party" representations as set out in Section 45 of NI 93-101 in order to determine EDP status during the transition period, is a welcome starting point. PMAC requests that, all derivatives transactions with "permitted clients", "accredited counterparties" or "qualified parties" pre-existing the effective date of NI 93-101 be grandfathered. We believe that these sophisticated clients will not be prejudiced by this approach and that grandfathering all such pre-existing transactions will ease the regulatory burden without any corresponding deleterious impact to markets or EDPs.

In the alternative, should the CSA not be amenable to grandfathering these transactions, we believe that the application all of the EDP requirements should be delayed for such pre-existing transactions for a period of 4 years. We believe that this is an appropriate way to transition firms and these sophisticated clients into the derivatives business conduct requirements, while still allowing these relationships to be renewed and revised in the normal course of business.

International Standards and the robust Canadian regulation of advisers

The substance and purpose of NI 93-101, as explained by the CSA in the Consultation, is to develop an instrument to protect investors, reduce risk, and improve transparency and accountability in the OTC derivatives market. The Consultation is also a response to IOSCO's concerns about the contribution to the financial crisis of 2008 by some firms dealing in derivatives as a result of not effectively managing their own derivatives-related risks. Importantly, NI 93-102 references IOSCO's comments that:

> Historically, market participants in the OTC derivatives markets have, in many cases not been subject to the same level of regulation as participants in the traditional securities market. This lack of sufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008. [emphasis added]

PMAC believes that portfolio managers are already robustly regulated and overseen by members of the CSA under NI 31-103 and that the creation of a parallel - but not identical - regulatory regime to oversee this category of registrants is not warranted to address IOSCO's OTC derivatives market concerns.

We believe the CSA has approached the Consultation from the point of view that advisers must be regulated in the same way as dealers in order to satisfy Canada's IOSCO

obligations with respect to OTC derivatives. PMAC feels that this approach does not adequately account for unique circumstances regarding the regulation of portfolio management firms. These factors include the rigorous proficiency requirements required of advisers, the fiduciary duty of care owed by advisers to their investors, minimum insurance and capital requirements, and the robust, principles-based regime that advisers must adhere to under NI 31-103. We believe these factors warrant the exclusion of portfolio managers from the application of NI 93-101.

Concerns regarding applicability of NI 93-101 to portfolio managers

Despite the amendments to NI 93-101 and the publication of the Registration Consultation, PMAC continues to believe that a compelling policy rationale for requiring separate market conduct and registration rules for advisers with respect to derivatives has not been adequately articulated. We respectfully disagree with the CSA's response to the 2017 Proposal that the proposed business conduct regime for derivatives advisers does not unnecessarily duplicate certain requirements under NI 31-103 for portfolio managers.

We do not believe that investors or the Canadian capital markets will benefit from the CSA imposing duplicative and additional market conduct requirements on advisers in the derivatives context.

Application of NI 93-102 to foreign firms

One of PMAC's key concerns with respect to NI 93-101 and NI 93-102 arises in connection with how the CSA will treat foreign derivatives firms who are exempt from registration under equivalent foreign or domestic regulations but would nonetheless be required to be registered in Canada under the Registration Consultation and be required to comply with the requirements proposed in NI 93-101 by virtue of tripping over the business trigger. In setting out the anticipated costs and benefits of NI 93-102, the CSA note:

> There is a possibility that foreign derivatives firms may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with [NI 93-102], which would reduce Canadian derivatives parties' options from derivatives services. However, [NI 93-102] contemplates a number of exemptions, including exemptions for smaller derivatives dealers that only deal with eligible derivatives parties and for derivatives firms located in foreign jurisdictions, which are subject to and in compliance with equivalent requirements for foreign firms. These exemptions could significantly reduce compliance costs associated with [NI 93-102] for derivatives firms located in and complying with the laws of approved foreign jurisdictions.

Members are concerned about the impact on end investors should the complexity, filing burden and/or cost of the Canadian derivatives regime deter international participation in our markets.

Canadian rules with respect to derivatives, should account for our reliance on foreign markets for liquidity and access to foreign advisers in order to achieve a balance of interests. PMAC has concerns regarding the proposed requirement that foreign derivatives firms that are exempt from registration under equivalent foreign or domestic regulations

would nonetheless be required to be registered in Canada under NI 93-102 and be required to comply with NI 93-101. We continue to strongly urge the CSA to extend certain aspects of the international adviser exemption in Section 8.26 of NI 31-103 as well as the international sub-adviser exemption set out in subsection 8.26.1 of NI 31-103 in both NI 93-101 and NI 93-102 so that existing business relationships and access to investments for firms' clients will not be disrupted.

We understand that the CSA wishes to limit the exemption from the registration requirement to firms that are "registered, licensed or otherwise authorized under the securities, commodity futures or derivatives legislation of a foreign jurisdiction specified in Appendix G" of NI 93-102 (**Appendix G**). PMAC believes that, if the CSA is prepared to rely on the substituted compliance of those foreign jurisdictions for firms that must be regulated, it also follows that the exemptions from derivatives regulation that those jurisdictions have approved should similarly be valid exemptions for the purposes of NI 93-101 and NI 93-102.

Further, PMAC is not aware of other jurisdictions that have registration regimes applicable to derivatives advisers in respect of OTC derivatives transactions, so substituted compliance as currently contemplated will not be meaningful. For this reason, we recommend that an exemption from the registration and business conduct requirements also be available where a foreign derivatives adviser is not required to be registered in its home jurisdiction to advise in respect of derivatives, if that foreign derivatives adviser is registered, or exempt from registration, under its home jurisdiction's securities legislation.

We believe that the CSA can concurrently take a meaningful and principles-based approach to addressing the issue of substituted compliance while, at the same time, avoiding implementing measures that would unnecessarily disrupt cross-border trade flows. Certain members have suggested that one way of achieving a more principles-based assessment of substituted compliance would be to permit IOSCO member jurisdictions that have implemented IOSCO's recommendations in this respect to automatically be included in the CSA's substituted compliance regime.

If the CSA's derivatives regime is implemented without a workable exemption for international advisers, members have voiced concerns that Canadian firms may be unable to attract and hire top international talent for their investors since international advisers may be deterred from participating in the Canadian market without an exemption. We also note that the Canadian registered firm would continue to be – as is currently the case under subsection 8.26.1(1)(b) of NI 31-103 – responsible for any loss that arises out of the failure of the international sub-adviser and that the sub-adviser would be subject to the Canadian registered firm's initial and on-going due diligence, if an exemption similar to section 8.26.1 of NI 31-103 is included in NI 93-102 and NI 93-101.

While PMAC strongly recommends that the CSA not adopt the proposed substituted compliance concept in the derivatives regime, we understand that Appendix G will be completed and published for comment under separate cover once the CSA has completed an equivalency analysis. We believe that, in order to respond to evolving regulatory regimes, the CSA should develop a way that would permit the efficient evaluation and addition of new

jurisdictions to the list of acceptable substituted compliance jurisdictions under Appendix G, as opposed to risking a static list that could become outdated.

Members have also raised concerns about the increased costs to Canadian dealers that provide their services to Canadian portfolio managers. Such Canadian dealers may not only experience increased costs directly as a result of proposed NI 93-101 and NI 93-102, but may also experience increased costs indirectly as a result of having fewer international dealers to deal with, should there be significant foreign dealer exits from Canada. Such costs at the dealer level could have the unintended negative consequence of wider spreads and a drag on investment returns for Canadians.

Senior derivatives manager and reporting requirements

PMAC is pleased that the CSA made revisions to NI 93-101 to allow the senior derivatives manager to delegate his or her responsibility to submit a report to the board of directors to the firms' CCO. PMAC believes that this ability makes sense from a compliance oversight standpoint, and is also reflective of the business reality that boards prefer to deal with a set number of known and trusted executives.

We believe that the requirement for the derivatives UDP to report to the board of directors of a firm in the circumstances set out in Subsection 27(3)(c) of NI 93-102 is duplicative of the requirement for the senior derivatives manager (or, if delegated, the CCO) to report to the board in the circumstances set out in Subsection 31(2) of NI 93-101 and as elaborated on in the Proposed Companion Policy to NI 93-101. We believe that deleting the requirement in Subsection 27(3)(c) of NI 93-102 would clarify the reporting obligations without creating a duplicative burden that does not bolster the compliance function.

We also refer the CSA to PMAC's submission on the Registration Consultation where we highlight a number of comments and concerns surrounding the roles and responsibilities of the senior derivatives manager, UDP, CCO and CRO and pose a number of questions about the responsibility of and interplay between these various roles.

Overall, we continue to believe that the requirement to hire or designate a senior derivatives manager is onerous and unnecessary. We urge the CSA to simplify and streamline personnel and reporting requirements and believe that failure to do so could negatively impact the competitiveness of Canada's market and of our firms, without a corresponding market or investor protection benefit.

RESPONSES TO SPECIFIC CONSULTATION QUESTIONS

> 2. ***Definition of "eligible derivatives party".*** *Are the criteria in paragraphs (m), (n) and (o) appropriate?*

While PMAC had hoped the CSA would leverage the existing "permitted client" definition instead of introducing a new category of sophisticated investor, given the CSA's decision to continue with the definition of EDP, we encourage as much consistency as possible between NI 31-103, NI 93-101 and NI 93-102 based on the philosophy of these being parallel regulatory regimes and in order to avoid confusion and complexity. As such, we request

that the CSA amend the definition of EDP to include any non-individual person that is a "permitted client", as such term is defined in NI 31-103.

While PMAC believes the criteria in subsection (n) of the EDP definition are an appropriate way for the CSA to harmonize EDP with the "accredited counterparty" category under the *Derivatives Act* (Quebec). However, members have noted concerns, however, that such criteria remains insufficiently harmonized with the "eligible contract participant" category under the U.S. Commodity Exchange Act. We believe it is crucial to ensure as much harmonization as possible.

We note that, as proposed, NI 93-101 and NI 93-102 will require many firms to potentially grapple with four different sophisticated investor definitions: "accredited investor", "permitted client", "qualified party" and EDP. This is not only overly cumbersome for firms, but it is likely to be frustrating for investors who will be required to complete all the resultant paperwork. We continue to believe that this additional complexity is unwarranted.

PMAC further asks the CSA to reconsider the requirement for firms to obtain a written representation of an institutional EDP's "knowledge and experience" to evaluate information about derivatives. For institutional EDPs, the requirement to obtain such a representation only creates regulatory burden without corresponding risk reduction or investor protection benefits. Institutional EDPs do not require these additional protections and have the resources and the expectation that they will contractually negotiate their own commercial arrangements with derivatives advisers.

> *5.* ***Derivatives Party Assets.*** *[…] 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.*

PMAC believes that it would be appropriate to adopt an informed consent model.

We believe that the CSA has yet to provide clarification regarding the intended application of the provisions related to segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client. While these provisions may make sense from a dealer's perspective, it is unclear how they would apply to a portfolio manager with a fiduciary duty not to commingle client assets.

CONCLUDING COMMENTS

We would like to thank the CSA for the work, thought and outreach that has gone into developing and publishing this Consultation as well as the Registration Consultation.

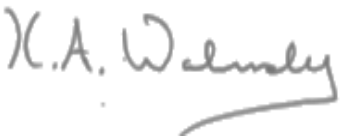
We continue to believe that it is of utmost importance for the CSA not to impose one-size-fits-all rules on portfolio managers and that, instead, investors and the market are better served by leveraging more principles-based regulation that recognizes the already robust regulatory requirements and legal duty of care these professionals owe their clients.

We would be happy to speak with you further about any of the remarks in our letter and/or in our submission on the Registration Consultation.

We look forward to continuing our dialogue with the CSA on these matters at the up-coming OSC Roundtable on Derivatives.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



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