September 17, 2018

BY EMAIL
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

Me Anne-Marie Beaudoin
Corporate Secretary
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Grace Knakowski
Secretary
Ontario Securities Commission
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comments@osc.gov.on.ca

Dear Sirs/Mesdames:

Re: **CSA Notice and Second Request for Comment – Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (collectively, the "Business Conduct Proposals")**

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to provide the following general comments on the Business Conduct Proposals and reply to the specific questions below.

[1]The CAC represents more than 15,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 154,000 CFA charterholders worldwide in 165+ countries and regions. CFA Institute has eight offices worldwide and there are 151 local member societies. For

While we will not be responding in a separate comment letter to the request for comments on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration* (collectively, the "**Registration Proposals**"), we considered the Registration Proposals in the context of our responses below and wish to comment on certain discrete aspects of those proposals.

The CAC supports the bifurcation of the Registration Proposals from the Business Conduct Proposals, in that we agree all derivatives advisers and dealers should be subject to certain minimum conduct standards, even if their activity does not trip the business trigger for registration. While there is room for debate on the scope of the Registration Proposals, particularly as it relates to incidental activity that would not trigger a registration requirement, we support the principles behind the Registration Proposals and the Business Conduct Proposals, which include reducing systemic risk and meeting IOSCO's international goals. We are also supportive of more harmonized standards for listed derivatives and OTC derivatives, particularly with respect to the reporting and disclosure by derivative parties.

The CSA should consider specifying in detail a de minimus exemption from the adviser registration requirement, particularly for portfolio managers utilizing OTC derivatives occasionally or for currency hedging in their managed investment funds/segregated portfolios, in order to have certainty with respect to whether such advisers require registration under the derivatives regime separate from their registration under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**"). This more clearly delineated de minimus exemption could be based on a low notional amount of outstanding derivatives and/or a small percentage of the net asset value of the portfolios. Advising in currency hedging only in the context of managed portfolios/investment funds could also explicitly be excluded. This would be preferable to a case by case or registrant-led determination of whether an entity is in the business of advising on derivatives. Some firms might commence the registration process out of an abundance of caution which would not be an efficient use of resources for either these firms or their regulators given the stated goals of the proposals.

The Registration Proposal includes requirements for risk management policies and procedures, including a requirement for an independent review of risk management systems. While we support the importance of independent reviews and raising awareness about risk and market stability, there are a few potential issues with the implementation of this requirement. The obligation may impose additional requirements and costs on smaller firms that may not have the resources for an internal independent review, especially those smaller firms that might otherwise fall outside of the scope of the Proposal should a de minimus threshold for derivatives advice exist, such as the one outlined above. Having to engage an external party to perform an independent review

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will require initial and ongoing due diligence and conflict analysis, and impose additional costs and oversight requirements on these firms. The effectiveness of this requirement will also vary based on the persons or firms providing the independent review, and thus additional guidance on the qualifications and experience of the reviewers, together with expectations on the scope of the review would be helpful. Evaluating the effectiveness of a risk management framework should be based on a meaningful understanding of the firm being evaluated, as well as how the firm's activities intersect with other entities within the larger financial system and contribute uniquely to systemic risk.

We understand that a number of the provisions in the Business Conduct Proposals were modified from existing provisions in NI 31-103 to reflect the nature of the derivatives markets. However, the CAC believes that additional guidance and outreach to current registrants who will be required to register in additional derivatives categories by the Registration Proposals will be quite critical for smooth implementation of the two proposals. For example, while it is clear that the definition of an "eligible derivatives party" will differ from the current definition of a "permitted client", the regulatory expectations for registrants dealing with or advising persons and entities from either or both categories is less clear. Additional guidance, registrant outreach, and easily-utilized tools for registrants would be helpful.

While Appendix A in the consultation paper contrasts the approach of the Business Conduct Proposals to NI 31-103, it is only the context of the applicability of certain provisions, and not in the context of specific new requirements that existing (or new) registrants should implement that go above and beyond existing NI 31-103 compliance mechanisms. An appendix identifying the difference in the two definitions of "permitted client" and "eligible derivatives party" would also be of benefit to registrants subject to the rules.

Registrants who are currently meeting their obligations under NI 31-103 by having a robust culture of compliance, effective policies and procedures and staff who understand the KYC, KYP, and suitability determinations may still struggle with the Business Conduct Proposals without targeted, specific information with respect to the additional policies and procedures expected of them under the new regime for OTC derivatives. The vast majority of registrants wish to comply with regulatory changes and expectations at the outset, but without additional guidance they may fall offside, resulting in significant deficiencies requiring both regulatory and registrant resources to rectify. While every registrant's business and policies differ, efficiencies would be gained if there were, for example, an illustrative list of additional policies or changes to policies and procedures that should be considered in light of the new requirements for common existing categories of registration. Registrants would benefit from additional tools and explanations, through guidance notices, registrant outreach, staff notices or otherwise, to help meet their new obligations.

As another example, Section 12 of the Business Conduct National Instrument describes a derivative firm's suitability obligation prior to transacting in a derivative. In principle, we understand why there needs to be a more robust process for "retail clients"

as compared to eligible derivative parties. However, it is unclear how the suitability determination should differ from the existing suitability determination obligation under NI 31-103. Many existing registrants already have a vigorous KYC process for individuals, including with respect to their experience with investing in various types of securities. However, the proposed new Companion Policy 93-101 suggests that for derivatives in particular, the requisite KYC information needed would differ on a case by case basis, which may be difficult to apply in the absence of additional information as to what is required in various circumstances. Additional guidance for registrants with respect to a client's experience with investing in derivatives could be beneficial, not only for KYC purposes but in connection with certain branches of the definition of an eligible derivatives party.

We wish to respond to the specific questions posed as follows.

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.*

The definition should likely be expanded to include discretionary portfolio management/advisory authority, as many investment managers will have advisory relationships with managed accounts and investment funds that they do not control by virtue of the definitions, and also do not consolidate for accounting purposes.

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? 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.

Exemptions are provided from certain provisions of the Business Conduct Proposals for derivatives traded with an EDP on a derivatives trading facility that are submitted for clearing, where a firm may not know the identity of its derivatives party prior to the anonymous execution of a transaction. We note that the OTC derivatives market continues to rapidly evolve, and trades executed on certain multi-level trading platforms that may not be submitted for clearing should be considered for a similar exemption or exemptive relief on a case by case basis if such platforms become widely

adopted outside of Canada. It is important that the Business Conduct Proposals do not artificially limit innovative trading platform adoption in Canada.

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.

Additional guidance and outreach to current registrants with respect to any such requirement will be critical.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council for*
Canadian CFA Institute Societies

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