EXECUTION VERSION

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March 21, 2022

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the "Rules") and Proposed Companion Policy 93-101 Published January 20, 2022 (the "Companion Policy", and together with the Rules, the "Proposed Draft")[1]

INTRODUCTION

The Canadian Market Infrastructure Committee ("**CMIC**") is pleased to provide this comment letter on the Proposed Draft.

CMIC's purpose is to assist regulatory and legislative authorities in Canada by providing the consolidated views of key Canadian market participants on proposed Canadian regulatory and legislative changes having an impact on over-the-counter ("**OTC**") derivatives, with the goal being to ensure that the regulation of the OTC derivatives markets in Canada would not have detrimental effects on the Canadian market. CMIC was formed in 2010 at the request of representatives from the Bank of Canada, Canadian Securities Administrators (the "**CSA**"), and the Federal Department of Finance, and since then, CMIC has been providing commentary on proposed draft rules and consultation papers with respect to the regulation of the OTC derivatives market in Canada. CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian OTC derivatives market as its membership has been intentionally designed to present the views of both the 'buy' side and the 'sell' side of the Canadian OTC derivatives market, including, but not limited to, both domestic and foreign owned banks operating in Canada, as well as major Canadian institutional market participants. A list of the CMIC members who have endorsed this letter appears at the end of this letter.

CMIC's comment letters have consistently supported the harmonization of rules across Canada. Since the OTC derivatives market is a global market with Canada representing only approximately 4% of that global market, it is very important that our OTC derivatives rules are harmonized across Canada and also harmonized with regimes in larger markets outside Canada where such harmonization is appropriate given the relatively small size of the Canadian market. It would

[1] See *CSA Notice and Third Request for Comment*, (2022), 45 OSCB 709, available here.

otherwise become too costly for a foreign counterparty to enter into OTC derivatives transactions with a Canadian counterparty if that would require analysis and compliance with rules that are different across provinces and territories and inconsistent with global rules.

COMMENTS

End-User Exemption

We note, and appreciate, the added guidance in relation to the end-user exemption for all types of market participants. However, one of the factors described in the Companion Policy which may indicate that a person or company is in the business of trading derivatives is whether an activity is carried on with repetition, regularity or continuity. The Companion Policy states that frequent or regular transactions are a common indicator that a person or company may be engaged in trading for a business purpose.

Many end-users, such as pension funds and insurance companies, regularly and frequently enter into OTC derivatives transactions for a business purpose. While the end-user exemption under section 37 of the Rules is helpful, the Companion Policy on page 821 provides an example that a person or company that frequently and regularly transacts in derivatives to **hedge** business risk may qualify for this exemption. However, many end-users will frequently enter into equity, commodity and credit derivatives trading strategies for market returns and not necessarily to hedge business risk. As long as such an end-user trades with a derivatives dealer, and otherwise satisfies the conditions under section 37, it is CMIC's view that such person or company should qualify for the end-user exemption. CMIC recommends that the Companion Policy be amended to add an additional example where a person or company may qualify for this exemption even if it is not entering into derivatives trades for hedging purposes but solely for purposes of gaining market returns, provided such person or company trades with a derivatives dealer.

Assessing knowledge and experience

The Rules and the Companion Policy, as currently drafted, appear to contain inconsistencies with respect to how a derivatives firm assesses whether it is transacting or advising (as applicable) an eligible derivatives party ("**EDP**"). The definition of "EDP" in paragraphs (m), (n), (o) and (p) states that the person or company or individual, as applicable, "has represented to the derivatives firm" that he/she/it has the requisite knowledge and experience to evaluate the information provided, the suitability of the derivatives and the characteristics of the derivatives to be transacted. The commentary under section 1 of the Companion Policy on page 799 states that "if the derivatives firm has not received a written statement from a derivatives party, the derivatives firm should not consider the derivatives party to be an eligible derivatives party". Yet, also on page 799, there is a statement that a "derivatives firm should take reasonable steps to determine if a derivatives party is an eligible derivatives party" and that a derivatives firm "may" rely on factual representations (unless a reasonable person would have grounds to believe that such statements are false).

CMIC recommends that the definition of EDP under paragraphs (m), (n), (o) and (p) be revised to allow a derivatives firm flexibility in determining whether a derivatives party has the requisite knowledge and experience, instead of being required to only rely on written representations. Based on the 10+ years experience of dealer members of CMIC dealing with outreach requirements under derivatives rules, written representations are not always provided by clients in all cases despite multiple follow-up requests by CMIC dealer members. In order to minimize market disruption, we believe that a derivatives firm should be afforded the flexibility of considering other factors in determining whether the derivatives party has the requisite knowledge and experience and satisfies any applicable financial threshold (for example, the factors set out on page 800 of the Companion Policy, such as the frequency and regularity of entering into such transactions, experience and/or

training of the derivatives party's staff, and whether the derivatives party has obtained independent advice and publicly available information). We therefore propose that each of paragraphs (m), (n), (o) and (p) be amended as follows (underlined wording is the proposed amendment):

> …has represented to the derivatives firm, in writing, or a derivatives firm has taken reasonable steps to verify, that…

Corresponding changes would be required to the Companion Policy.

We note that this approach is taken under US rules. For example, the SEC business conduct requirements[2] state that:

> A security based swap dealer or a major security-based swap participant shall verify that a counterparty meets the eligibility standards for an eligible contract participant before entering into a security-based swap with that counterparty,… [emphasis added]

Instead of expressly requiring a dealer to rely on written representations only, the wording requires that the dealer verify that the counterparty is an eligible contract participant and it is up to the dealer to determine how that should be accomplished. We have proposed language which imports an element of taking "reasonable steps to verify" a derivatives party's EDP status, as opposed to the wording under US rules which state "shall verify". The reason for this distinction is the fact that US rules do not include the element of "knowledge and experience" with respect to a party's eligible contract participant status, unlike paragraphs (m), (n), (o) and (p) of the definition of EDP which require that a derivatives party has the requisite knowledge and experience to evaluate the information provided, the suitability of the derivatives and the characteristics of the derivatives to be transacted. It is therefore more appropriate to use the wording "taken reasonable steps to verify" under Canadian rules since it would be difficult to conclusively prove a derivatives party's knowledge and experience. Indeed, this is the approach taken under section 14 (Suitability) of the Rules which provides that a "derivatives firm…must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a derivatives party to transact in a derivative…both the derivative and the transaction are suitable for the derivatives party."

Further, the Companion Policy should expressly provide that this verification or representation, as applicable, may be performed or obtained by a derivatives firm, and unless a derivatives firm has or is aware of information that would make it unreasonable to rely on such verification or representation, it may rely on such verification or representation. A derivatives firm would not be required to perform this assessment or obtain a fresh representation for every transaction. Again, this approach is consistent with US rules where, if agreed to by the parties, written representations in a master agreement or other agreement could be deemed to be renewed with each subsequent swap transaction, absent any facts or circumstances to the contrary.[3]

Fair Dealing

We note that the commentary with respect to fair dealing on page 804 states:

> We expect there to be a rational basis for a discrepancy in price where essentially the same derivative is transacted with different derivatives parties. Factors that indicate a rational basis could include the level of counterparty risk of a derivatives party, the derivatives party's trading activity, or relationship pricing.

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[2] Title 17, Chapter II, Part 240, § 240.15Fh-3. Available here.

[3] CFTC Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 17 CFR Parts 4 and 23, Vol. 77, No 33 9734 at 9756.

We believe that the reference to "counterparty risk" could be interpreted as meaning only credit risk and not capital risk. There may be certain counterparties or transactions that are not eligible for netting, which would change the pricing applicable to transactions and could cause one derivatives dealer's pricing to be materially different from another's. CMIC therefore recommends that the wording of this sentence in the Companion Policy be clarified to add "capital risk" after the words "level of counterparty risk".

Transition Rules

Section 47 and Section 49

CMIC is supportive of an extended transition period of 5 years after the effective date of the Rules. We note that this transition period effectively ends 6 years after the final publication date of the Rules, assuming the one year period under section 49 does not change. While the current drafting of sections 47 and 49 is clear on this point, it would be helpful if the Companion Policy were amended to expressly state this.

CMIC also supports the policy rationale under section 47 of facilitating the transition to the new rules for non-individual derivatives parties without having to conduct a separate outreach. Allowing derivatives firms to rely on the representations set out under section 47(2) (the "**Transition Representations**") made by non-individual derivatives parties in existing documentation for a period of 6 years after the publication of the Rules assists in this process (the "**Transition Period**"). However, we note two material concerns with respect to the transition provisions in the Rules which, in our view, significantly reduce the effectiveness of these provisions. To provide support for our recommendations, we asked our sell-side CMIC members to estimate the scope of the client outreach that would be required based on the Rules as currently drafted. While some members were able to provide a very rough estimate, due to the high numbers of ISDA agreements and limited searching capability for documentation, some had a hard time even estimating the number of derivatives parties that have not made any of the Transition Representations. This fact alone supports CMIC's conclusion that the client outreach, based on the current drafting of the Rules, would be a significant undertaking.

(i) The first such material concern is that there are certain derivatives parties that would otherwise qualify as EDPs where a derivatives firm would not have obtained any of the Transition Representations. Therefore a client outreach would need to be conducted (which would include reviewing ISDA agreements entered into for **all** counterparties (in the case of Canadian derivatives firms) to determine whether the Transition Representations have been given, contacting clients, explaining the Rules, following-up and obtaining the applicable representations), and completed within the one year transition period set out under section 49. We believe that the number of derivatives parties to which this would be applicable is material, for the reasons described below. One Canadian bank member of CMIC has provided a rough estimate that approximately 50% of its clients would not have any of the Transition Representations currently in their ISDA agreements.

1. Certain Canadian financial institutions are exempt from the requirement to be registered under section 35.1 of the *Ontario Securities Act* (the "**OSA**") and accordingly, when facing an Ontario derivatives party, there is no requirement to obtain a "permitted client" representation. However, to confirm that a prospectus requirement does not apply, those financial institutions may have obtained only an "accredited investor" representation (as such term is defined under NI 45-106 *Prospectus Exemptions*). One Canadian bank member of CMIC estimates that approximately 10% of all of its ISDA agreements with Canadian derivatives parties would only have the "accredited investor" representation.

2. There is currently regulatory uncertainty and fragmentation with respect to derivatives dealer registration in Canada, particularly in Ontario (if the derivatives dealer does not qualify for the exemption under section 35.1 of the OSA), Newfoundland and Labrador, Northwest Territories, Nunavut, Prince Edward Island and Yukon (collectively, the "**Non-Exemption Jurisdictions**").[4] Unlike the other jurisdictions in Canada, when a derivatives firm faces a derivatives party from one of the Non-Exemption Jurisdictions, there is no requirement to obtain any of the Transition Representations, unless the derivatives dealer is a foreign swap dealer registered under the Dodd-Frank Act ("**Foreign Swap Dealer**") and thus is required to obtain the "eligible contract participant" representation. Therefore, this would impose a higher burden on Canadian derivatives firms relative to Foreign Swap Dealers. Although Canadian bank members of CMIC are also registered swap dealers under the Dodd-Frank Act, it is a requirement to include the "eligible contract participant" representation only when dealing with a US person.

3. It is not market practice by Canadian market participants for certain types of foreign exchange ("**FX**") transactions to be documented in standard form industry documentation such as an ISDA master agreement. Rather, derivatives firms will typically rely on an electronic trade confirmation to evidence the agreement of the economic terms of the FX transaction between the parties. The parties do not have the ability to add any additional representations to these electronic confirmations. As a result, none of these FX counterparties will have made the Transitional Representations. One Canadian bank member of CMIC estimates that the number of these FX counterparties would be in the tens of thousands.

4. Generally speaking, none of the Transition Representations would be included in any ISDA between a Canadian derivatives dealer and a foreign derivatives party, unless the foreign derivatives party is a US person. For example, when a Canadian derivatives dealer faces a foreign derivatives party subject to EMIR[5], the only status representation received by the Canadian derivatives dealer is whether its counterparty is a "Financial Counterparty" or a "Non-Financial Counterparty" ("NFC") and if it is an NFC, whether it is an "NFC+" (meaning it is above the clearing threshold) or an "NFC-" (below the clearing threshold).

5. ISDA agreements with special purpose vehicles ("**SPVs**") would not include any of the Transition Representations unless the derivatives firm were a Quebec entity or a Foreign Swap Dealer. SPVs are intentionally structured such that their net assets would be well below any of the financial thresholds for a permitted client or a qualified party, but these vehicles would otherwise qualify as eligible commercial hedgers. In our experience, SPVs would only enter into derivatives transactions for hedging purposes and would clearly have the requisite knowledge and experience given that the use of such SPVs involves sophisticated structures and experienced professional advisors and personnel.

(ii) The second such material concern relates to eligible commercial hedgers. Section 47 allows a derivatives firm to treat a derivatives party as an EDP during the Transition Period if the derivatives firm has previously received one of the Transition Representations from the derivatives party, for example, the accredited counterparty representation or the qualified party representation. However, if the derivatives party is an eligible commercial hedger, in order to have only the "core" obligations under section 7(3) of the Rules apply, derivatives firms would still need to conduct an outreach in order to obtain the waiver required under section 7(2)(c) (the "**Waiver**"). As noted below in our response to Question 4, CMIC submits that most, if not all, Canadian banks will only want to transact

[4] *R. J. O'Brien & Associates, LLC (Re)* (2021), 44 OSCB 2306, paragraphs 12-25. Available here.

[5] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, including as it forms part of 'retained EU law" as defined in the European Union (Withdrawal) Act 2018 (as amended from time to time).

with derivatives parties that are EDPs and, if the derivatives party is an individual or an eligible commercial hedger, only if the Waiver is obtained. Also noted below, eligible commercial hedgers comprise a significant portion of Canadian banks' mid-market client base and, as currently drafted there is effectively no benefit to relying on the Transition Representations from eligible commercial hedgers since they are treated the same as non-EDPs if they have not provided a Waiver. Accordingly, an outreach would need to be conducted with respect to this entire group of counterparties and, in our experience, this group of counterparties has the lowest rate of response to information requests. This places a significant burden on Canadian banks and increases the risk of market disruption for their mid-market clients who are eligible commercial hedgers since this outreach would need to be conducted and completed within the one year period after publication of the final Rules. If Waivers have not been obtained by that date, there is a risk that these eligible commercial hedgers will not have continued access to hedging transactions.

Therefore, to reduce the burden placed on derivatives firms and for the other reasons set out above, CMIC urges the CSA to amend the transition provisions under the Rules as follows:

1. include the "accredited investor" representation as well as the EMIR "financial counterparty" and "NFC+" representations as Transition Representations since parties that provide these representations are considered to be sophisticated counterparties;

2. expressly provide under sections 47 and 48 that even where SPVs have not made one of the Transition Representations prior to the effective date, derivatives firms facing such SPVs would not need to conduct a special outreach to those parties and would not require a Waiver from those parties to treat them as EDPs during the Transition Period. Another example of such exclusionary treatment of SPVs because of their unique characteristics is found in the exclusion of SPVs from margin rules under federal Canadian financial services prudential regulation by OSFI[6];

3. to reduce the significant burden placed on Canadian financial institutions trading short-term FX transactions, the Rules should expressly provide that such counterparties will be deemed to be EDPs during the Transition Period, including deeming such counterparties to have the requisite knowledge and experience unless a derivatives firm has or is aware of information that would make it unreasonable to deem that such counterparties have the requisite knowledge and experience. The obligations under the Rules relating to short-term FX transactions do not depend on whether the counterparty is an EDP and in fact, if the counterparty is not an institutional counterparty, any short-term FX transaction entered into with such counterparty is out of scope. Therefore, Canadian financial institutions should not be required to conduct a client outreach for these counterparties within the period set out under section 49 (as currently drafted, one year). Many of these counterparties would be out of scope for trade reporting purposes and would not have had experience with ISDA documentation or completing the Canadian representation letter and the diligence required to educate and follow-up with them would consume significant resources and would take much longer than the one year period under section 49 (and indeed, based on the client outreach experience under the trade reporting rules, it would take longer than the 6 year period under section 49);

4. to ensure derivatives firms have sufficient time to conduct the required client outreach, increase the one year period under section 49 to a minimum of two years; and

[6] Office of the Superintendent of Financial Institutions, Guideline E-22, paragraph 2.

5. expressly provide that, in the case of eligible commercial hedgers, as long as one of the Transition Representations (as amended under recommendation 1 above) has been made prior to the effective date, eligible commercial hedgers would be deemed to have given the Waiver, unless the eligible commercial hedger has indicated in writing that it does not agree to the Waiver.[7]

Drafting comments under Section 47

In addition to amending section 47 to address the recommendations discussed above, CMIC proposes the following drafting comments relating to section 47, as follows:

1. The purpose of section 47(3) is not clear. First, we think the words "Despite subsection (2)" should be deleted, and the words "if either" should be changed to "if both".

2. Often the Transition Representations are deemed repeated on each date that a transaction is entered into. The Companion Policy should clarify that such deemed repetition with respect to a transaction entered into after the effective date of the Rules should not preclude a derivatives firm from benefiting from the transition provisions under section 47 since technically, that representation would be made after the effective date of the Rules. We note that, all things remaining the same with respect to the status of derivatives registration rules, derivatives firms will continue to require derivatives parties to make the applicable Transition Representations after the effective date.

3. The last paragraph under section 47 of the Companion Policy on page 825 should be amended as follows since a party that would be an eligible commercial hedger could qualify as such if it made the "accredited counterparty" or "qualified party" representation (underlined wording is the proposed amendment):

> The definition of "permitted client" does not include an "eligible commercial hedger". In any circumstance where a derivatives party is relying on the "eligible commercial hedger" category to qualify as an eligible derivatives party, the derivatives firm is required to confirm a derivatives party's status as an eligible derivatives party by using the definition and the categories of eligible derivatives party in subsection 1(1) of the Instrument, unless the derivatives party has represented that it is a "qualified party" or an "accredited counterparty" prior to the effective date of the Instrument, in which case the derivatives firm would not be required to confirm a derivatives party's status as an eligible derivatives party and can rely on the transition provision under section 47 of the Instrument.

Section 48

As currently drafted, it is unclear to what extent the Rules would apply to transactions that were entered into before the effective date ("**legacy transactions**"). For example, section 48 provides that only the Fair Dealing obligation under section 8 applies to legacy transactions, but only if a derivatives firm has taken reasonable steps to determine that a derivatives party is a permitted client, an accredited counterparty, a qualified party or an eligible contract participant. As noted under the discussion of section 47 above, there are certain derivatives parties from whom a derivatives firm would not have received any of such representations but would otherwise be EDPs. Therefore, as currently drafted, this implies that all obligations under the Rules would apply to all legacy

[7] For example, if, during the course of updating information from a derivatives party during the Transition Period the derivatives party is presented with a form of Waiver and expressly selects the option of not agreeing to waive any or all of the non-core obligations, the derivatives firm would no longer be able to rely on this deemed Waiver.

transactions of such derivatives parties. This is confusing since clearly certain obligations under the Rules apply only prior to trading, and further, it is contrary to legislative conventions to have legislation apply retroactively. At a minimum, should any obligation under the Rules apply to legacy transactions, it should apply only to the extent practicable.

CMIC recommends that once in force, the Rules apply only to transactions entered into after the effective date, except that the Fair Dealing obligation only would apply to legacy transactions in respect of conduct of a derivatives firm occurring after the effective date, irrespective of a derivatives party's status.

Eligible Contract Participant as a category of EDP

CMIC supports the inclusion of a provision under the Rules which deems that an eligible contract participant under section 1(a)(18) of the United States *Commodity Exchange Act* should be treated as an EDP permanently, and not only pursuant to the transition period under sections 47 and 48 of the Rules. We are concerned that many foreign derivatives dealers who only deal with eligible contract participants may determine that the additional time and resources required to identify whether a Canadian counterparty is an EDP will not be worth the benefit of trading with such counterparties. This could significantly reduce liquidity in the Canadian OTC derivatives market. Given that the thresholds under the EDP definition are lower than under the eligible contract participant definition, and the US business conduct rules are robust, in our view, giving derivatives dealers the ability to treat eligible contract participants as EDPs on a permanent basis would not be detrimental to the Canadian OTC derivatives market and would in fact assist in maintaining an important source of liquidity in the Canadian OTC derivatives market.

Extraterritoriality of the Rules

We note that there is an extraterritorial impact under the Rules and would ask the CSA to re-consider the comments made in our previous submission.[8] This extraterritorial impact places Canadian derivatives dealers trading from foreign branches at a significant disadvantage as we believe foreign end-users will not want to be forced to complete yet another representation letter in order to continue trading with Canadian derivatives dealers, and instead would choose to trade with non-Canadian dealers. For example, an NFC- counterparty trading with a European bank would not be required to complete an EDP representation letter. We submit that these NFC- counterparties would not feel that they need the extra "protections" under the Rules simply because they are dealing with a Canadian bank. CMIC therefore recommends that an exemption from the Rules should be available if a Canadian dealer faces a derivatives party solely from its foreign office/branch.

In the alternative, paragraph (m) of the EDP definition should be amended to remove the "requisite knowledge and experience" requirement when a Canadian dealer faces a foreign derivatives party. We believe that the net asset financial threshold test of $25 million is a sufficient proxy for determining a derivatives party's sophistication. This is different than the commercial hedger branch of the EDP definition under paragraph (n) or the individual EDP branch under paragraph (o) where, arguably, such parties could potentially be considered "retail" unless a knowledge and experience assessment is undertaken. The "permitted client" definition under NI 31-103 simply uses a bright line, net asset test of $25 million to determine an investor's sophistication and we submit that given a corporation's level of resources at this level, it would have sufficient sophistication to evaluate a derivatives transaction. Limiting this request only to foreign derivatives parties with net assets greater than $25 million would significantly reduce the burden placed on Canadian derivatives dealers and ensure they remain competitive in this global derivatives market since a client outreach to this category of derivatives parties would not be necessary. Canadian derivatives dealers would still need to comply

[8] See the CMIC response letter dated September 12, 2018, pages 8-10 on the previous draft of the Rules. Available here.

with the core obligations under the Rules for foreign corporate end-users, in addition to the foreign rules applicable in the local jurisdiction for each foreign counterparty, and therefore this approach still meets the counterparty protection objective while reducing compliance costs/burden for Canadian derivatives dealers and ensuring Canadian derivatives dealers remain competitive as compared with foreign dealers.

Drafting Comments

Under paragraph (c) of the definition of "Canadian financial institution", Confédération des caisses populaires et d'économie Desjardins du Québec is mentioned, but no longer exists. Please replace with "Fédération des caisses Desjardins du Québec".

In section 23, we note that the initial margin regime under OSFI Guideline E-22 is expressly mentioned, however, the AMF regime on initial margin is not. We believe it should be captured under section 23(c), however, for clarity, CMIC recommends that section 23 be amended to expressly refer to the AMF initial margin regime.

On page 818, there is an "NTD" included in footnote 5 which should be deleted.

On page 818, there are two references to paragraph 31(1)(b) which we believe should refer instead to paragraph 31(2)(b).

On page 820, there is a reference to paragraph 34(c), which does not exist.

On page 824, under Section 45, there is a reference to Appendix E which we believe should refer instead to Appendix F.

Responses to Questions in CSA Notice

1) Foreign Liquidity Provider Exemption

We have introduced a new foreign liquidity provider exemption in section 36 of the Instrument for foreign dealers that transact with derivatives dealers located in Canada. This is an outright exemption from the requirements in the Proposed Instrument intended to preserve market access and maintain general liquidity in the inter-dealer market. As a result, a Canadian derivatives dealer, regardless of its size, will benefit from this provision. This also means that the core provisions in the Instrument will not apply when a local derivatives dealer is transacting with a foreign derivatives dealer.

Do you support including this additional exemption in section 36 of the Proposed Instrument?

Yes, CMIC supports the new foreign liquidity provider exemption. Without such an exemption, we believe that liquidity in the Canadian OTC derivatives market would be materially impaired. The Canadian OTC derivatives market is only a very small part of the global derivatives market, and more than 80% of the Canadian market involves foreign banks. These characteristics mean that preserving foreign liquidity is essential for Canadian businesses to be able to hedge the risks associated with their operations. Introducing unique regulatory requirements would significantly reduce liquidity because the added regulatory burden would dissuade foreign banks from maintaining existing Canadian operations or existing Canadian coverage. To ensure liquidity is preserved in Canada, commercial opportunities in the Canadian OTC derivatives market should outweigh the costs and compliance burden while maintaining the integrity of Canadian OTC derivatives markets. It is CMIC's view that a Canadian derivatives dealer does not need the protections set out under the Rules when facing a foreign liquidity provider and therefore, this exemption is appropriate and necessary to maintain a robust Canadian OTC derivatives market.

2) Foreign Derivatives Dealer and Foreign Derivatives Adviser Exemptions—Comparability Determinations

A foreign dealer or adviser from a foreign jurisdiction that, on an outcomes-basis, has comparable requirements to those in the Instrument will receive a complete exemption from the Instrument where that foreign dealer or adviser complies with the conditions of the exemption in section 38 or the exemption in section 43. Outcomes-based assessments have been conducted for the jurisdictions listed in Appendices A and D. Please provide any comments you may have on the inclusion of any of the foreign jurisdictions listed in these Appendices.

Should any other foreign jurisdiction(s) with comparable requirements be added to these Appendices? Please explain your response with reference to the applicable legislation and related requirements.

Appendices A, D and E of the Rules list “any member country of the European Union” in the “List of Specified Foreign Jurisdictions” for purposes of the Foreign Derivatives Dealers exemption under section 38, the Foreign Derivatives Advisers exemption under section 43 and the Foreign Derivatives Sub-Advisers exemption under section 44. We have confirmed with UK counsel that both MiFID II[9] and MiFIR[10] are applicable in the three additional European Free Trade Countries (Iceland, Liechtenstein and Norway) with effect from 31 December 2019. Accordingly, we recommend that these Appendices be amended to include members of the European Economic Area.

3) Foreign Derivatives Dealer Exemption—Requirements

We have clarified that if the person or company that is a derivatives dealer is not located in the local jurisdiction (i.e., a foreign derivatives dealer), the obligations in the Instrument apply only to its dealing activities with a derivatives party that is located in the local jurisdiction. We have further clarified that any reports made by a foreign derivatives dealer to the regulator or securities regulatory authority under section 38(1)(d) are limited exclusively to the derivatives activity being conducted with a derivatives party located in Canada.

Do you support limiting the reports to the regulator contemplated by section 38(1)(d) to only cover a foreign derivatives dealer’s activities with a derivatives party that is located in Canada?

Yes, CMIC supports having the reports to the regulator contemplated by section 38(1)(d) cover a foreign derivatives dealer’s activities only if non-compliance with foreign laws creates or created, in the opinion of a reasonable person, a risk of material harm to a Canadian derivatives party or capital markets in Canada, or if the non-compliance is part of a pattern of material non-compliance relating to a Canadian derivatives party. However, in CMIC’s view, the timing of such reporting should be consistent with a foreign derivatives dealer’s reporting obligations to its home jurisdiction regulator.

In order to ensure Canadian OTC derivatives markets remain liquid, it is crucial to ensure that the Rules applicable to foreign derivatives dealers only apply in respect of activities which materially affect Canadian counterparties or which have a material negative effect on Canadian capital markets. In the vast majority of cases, derivatives transactions are entered into by the parent company/bank in a corporate group globally in order to maximize the effects of netting. Therefore, the derivatives activities of a foreign derivatives dealer are subject to rules of multiple jurisdictions. If a foreign derivatives dealer is not in compliance with rules of a foreign jurisdiction and such non-compliance has no material bearing on Canadian capital markets or Canadian counterparties, it is very difficult to see why a foreign derivatives dealer would choose to transact with a Canadian derivatives party and accept legal and regulatory liability when it could, instead, choose another counterparty that is not subject to the Rules. Furthermore, accelerated reporting of global regulatory actions to securities regulators in Canada creates a significant burden for large multinational dealers that need to coordinate regulatory reporting on a global scale.

Accordingly, this change to limit the reports to the regulator is a change which, in CMIC’s view is necessary to maintain liquid Canadian OTC derivatives markets, however, the timing of reporting of

[9] https://www.efta.int/eea-lex/32014L0065

[10] https://www.efta.int/eea-lex/32014R0600

regulatory actions should be aligned with the timing of such reporting to a foreign dealer's home jurisdiction regulator.

4) Commercial Hedger Category of the "Eligible Derivatives Party" (EDP) Definition

We have eliminated the $10 million financial threshold in the non-individual commercial hedger category of the definition of "eligible derivatives party" (in section 1(1) paragraph (n) of the Instrument). This means that more firms may qualify as eligible commercial hedgers under the Instrument. It is important to note, however, that, for a person or company to qualify as an eligible commercial hedger, they must provide a written waiver of their right to receive all or some of the additional protections in the Instrument (these are the additional protections that apply to all transactions with persons or companies that do not qualify as EDPs). Additionally, for a person or company to qualify as an eligible commercial hedger, they must still provide specific representations that they have the requisite knowledge and experience to evaluate certain derivatives information, as well as the suitability and characteristics of the derivative that is being transacted.

Do you support eliminating the $10 million financial threshold for qualifying as a commercial hedger? Will this new approach have any effect, positive or negative, on the ability of non-EDP clients to access liquidity from dealers or on a dealer's willingness to trade with non-EDP clients?

Yes, CMIC supports eliminating the $10 million financial threshold for qualifying as a commercial hedger from the EDP definition. With the $10 million financial threshold, derivatives parties currently able to hedge commercial risk with Canadian banks under an exemption would not qualify as EDPs under the Rules. At least one Canadian bank member of CMIC estimated that approximately 90% of its existing mid-market OTC derivatives client base would not qualify as EDPs if the $10 million financial threshold were retained under the commercial hedger category of the EDP definition. Another Canadian bank member of CMIC estimated that almost all of its mid-market FX clients would also not qualify as EDPs if the $10 million financial threshold remained in place. CMIC submits that most, if not all, Canadian banks will only want to transact with derivatives parties that are EDPs. Therefore, this new approach would have a positive effect on the ability of a broader group of commercial hedgers to access liquidity from dealers than would otherwise be the case if a financial threshold test were adopted. Accordingly, CMIC supports removing the $10 million financial threshold from the commercial hedger branch of the EDP definition. However, while removing this financial threshold test is helpful, Canadian banks may be unwilling to continue providing access to mid-market clients if implementing the rules imposes significant regulatory burden. CMIC urges the CSA to accept the recommendation made under the "Assessing knowledge and experience" section above on page 2 to provide flexibility to derivatives firms in determining whether a party is an EDP rather than requiring a party to make representations, as well as recommendation #5 under the "Transition Rules" on page 7 to deem that eligible commercial hedgers have given the Waiver during the Transition Period. Without implementing these two recommendations, the compliance burden for mid-market clients is significant and may lead to unintended consequences, such as the inability of mid-market clients to hedge transactions or accessing non-bank intermediaries for their liquidity needs.

5) Exemptions from the Designation and Responsibilities of a Senior Derivatives Managers

We have added exemptions in section 31.1 of the Instrument from the senior derivatives manager requirements for persons and companies to rely on (i) a general de minimis exemption available to all derivatives dealers whose aggregate gross notional amount of outstanding derivatives does not exceed $250 million or (ii) a de minimis exemption available to derivatives dealers that exclusively deal in commodities derivatives and whose aggregate gross notional amount of outstanding commodity derivatives does not exceed $3 billion.

Do you support the additional exemptions in section 31.1 from the senior derivatives manager requirements?

Yes, CMIC supports the additional exemptions in section 31.1 from the senior derivatives manager requirements. Derivatives dealers with *de minimis* derivatives transactions should not bear the burden of implementing the senior derivatives manager regime under the Rules as the costs of complying with those obligations would far outweigh the benefits to market participants.

6) Short-Term FX Contracts in the Institutional FX Market

We have applied a limited subset of provisions in section 3.1 of the Instrument to any Canadian financial institution that is a derivatives dealer with respect to its short-term FX transactions in the institutional FX market (commonly referred to as 'FX spot' in the 'wholesale FX' market) if its gross notional amount of derivatives outstanding exceeds $500 billion. This provision is only intended to capture those transactions between such derivatives dealers and their counterparties that are also considered wholesale FX market participants for the purposes of the FX Global Code of Conduct.

Do you support applying the specified provisions to this subset of derivatives dealers?

Provided that CMIC's recommendations above are accepted with respect to (i) providing flexibility and not requiring representations with respect to a party's EDP status and (ii) deeming a counterparty to a short-term FX transaction an EDP unless a derivatives firm has or is aware of information that would make it unreasonable to deem that counterparty an EDP, and given the limited subset of provisions of the Rules that would apply, the small number of Canadian financial institutions that would be in scope, and the reasons cited for the concern relating to conduct in the short-term FX market, CMIC supports the inclusion of section 3.1 of the Rules with respect to short-term FX transactions entered into with institutional market participants. As this activity is already subject to a compliance framework pursuant to the FX Global Code of Conduct, and subject to CMIC's earlier recommendations being adopted, the inclusion of section 3.1 is unlikely to cause a significant burden, but will enhance the integrity of the short-term FX market in Canada.

7) Treatment of Registered Advisers under Securities or Commodity Futures Legislation

We have added an exemption in section 45 for registered advisers under securities or commodity futures legislation from certain requirements of the Proposed Instrument listed in Appendix E if the registered adviser complies with corresponding requirements in NI 31-103 relating to a transaction with a derivatives party. In such cases, we anticipate that the existing compliance systems of the registered adviser can easily be extended to address any of the residual obligations of the Instrument, which residual obligations ensure that NI 31-103 requirements are extended to the registered adviser's derivatives activities.

Please provide any comments you may have on this approach and the requirements listed in Appendix E.

We understand that some derivatives parties rely on the expertise of a derivatives adviser to develop or implement derivatives trading strategies to help them achieve their organizational objectives. Section 7 of the Instrument exempts derivatives advisers from many of the requirements of the Instrument when they are advising an EDP.

Are there any scenarios where derivatives advisers that are advising EDPs should be required to comply with any of the requirements that section 7 provides an exemption from?

CMIC supports the approach under section 45 under which registered advisers under securities or commodity futures legislation are exempt from certain requirements of the Rules. There are not any scenarios we can think of where derivatives advisers that are advising EDPs should be required to comply with any of the requirements from which an exemption is provided under section 7.

8) Conflicts of Interest

Section 9 of the Instrument was developed with the intention that it would be generally consistent with the conflicts of interest provisions of NI 31-103. The Client Focused Reforms amended the conflicts of interest provisions of NI 31-103 (through amendments to section 13.4 and the addition of section 13.4.1) and adopted related companion policy changes. We are considering further changes to conform the conflicts of interest requirements so that they are consistent with those in NI 31-103, along with other changes to conform the requirements to be consistent with the requirements found in Client Focused Reforms.

Please provide any comments relating to the inclusion of such corresponding changes to the Proposed Instrument.

CMIC does not object to making the corresponding changes to section 9 of the Rules and the related commentary under the Companion Policy to conform with the amendments to the conflicts of interest requirements under NI 31-103 pursuant to the Client Focused Reforms, provided that any changes

made to the Rules and Companion Policy recognize the fact that there are differences between the derivatives and securities markets and that market participants should be given an opportunity to comment on these proposed changes if they are materially different from what is currently provided under the Proposed Draft. We believe that the conflicts of interest section should be interpreted flexibly and be sensitive to the context and to <u>derivatives</u> market participants' reasonable expectations. Given the differences between the derivatives and securities markets, it may not necessarily be appropriate to apply the conflicts of interest provisions to OTC derivatives market participants in the same manner as the relevant provisions would apply to securities market participants.

CMIC welcomes the opportunity to discuss this response with you.

The views expressed in this letter are the views of the following members of CMIC:

Alberta Investment Management Corporation
Bank of America
Bank of Montreal
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce
Citigroup Global Markets Inc.
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Intact Financial Corporation
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
Morgan Stanley
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
OPSEU Pension Plan Trust Fund
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank