Canadian Market
Infrastructure Committee

Via e-mail to: consultation-en-cours@lautorite.gc.ca
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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

September 12, 2018

Dear Sirs/Mesdames:

Re: Proposed National Instrument 93-102 *Derivatives: Registration* ("NI 93-102") and Related Proposed Companion Policy (the "Companion Policy", and together with NI 93-102, the "Proposed Rules")

INTRODUCTION

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

CMIC was established in response to a request from Canadian public authorities,[1] to represent the consolidated views of certain Canadian market participants on proposed regulatory and legislative changes in relation to over-the-counter ("**OTC**") derivatives. CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian OTC derivatives market. The membership of CMIC 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 (including a number of major pension funds) in the Canadian derivatives market. This letter reflects the consensus of views within CMIC's membership about the proper Canadian regulatory and legislative regime applicable to the OTC derivatives market.

[1] "Canadian public authorities" means representatives from Bank of Canada, Canadian Securities Administrators, Department of Finance and The Office of the Superintendent of Financial Institutions ("OSFI").

Our comments in this letter should be read in conjunction with CMIC's comment letter (our "**Business Conduct Response Letter**") submitted concurrently with this letter in response to the second publication of Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the "**Proposed Business Conduct Rule**"). We refer the Canadian Securities Administrators ("**CSA**") to Schedule D of this letter for our responses to the specific questions posed by the CSA in the notice accompanying the Proposed Rules.

EXECUTIVE SUMMARY

The following is a summary of our primary recommendations:

1. Canadian federally regulated financial institutions ("**FRFIs**") and their counterparties should be excluded from the application of the Proposed Rules.

2. Foreign derivatives dealers, if transacting only with eligible derivatives parties ("**EDPs**"), should be exempted from the application of the Proposed Rules as long as such foreign derivatives dealers are registered, exempt from registration or otherwise permitted to carry on the business of dealing in derivatives in their home jurisdiction, regardless of the location of such home jurisdiction.

3. The EDP definition should be amended to

   (i) remove the financial threshold for commercial hedgers under paragraph (n);

   (ii) remove the knowledge and experience requirements under paragraphs (m), (n) and (o); and

   (ii) lower the financial threshold in paragraph (m) for a non-individual from <u>net</u> assets of $25 million to <u>total</u> assets of $10 million.

4. A number of important recommendations with respect to derivatives advisory services.

EXCLUSIONS

A derivatives registration regime that is as expansive and inclusive as the regime that is contemplated by the Proposed Rules is not appropriate for the Canadian market. The OTC derivatives market is a global market[2] with Canada representing only approximately 4% of that global market[3]. CMIC supports the following view of ISDA, one of the largest international financial markets industry associations, in its public comment letter[4] on Consultation Paper 94-107 *Derivatives: Registration*:

> As noted in our January 2011 Comment Letter, we urge the Committee to consider the global nature of the markets when creating regulations for OTC derivatives to ensure that such

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[2] In other words, a large majority of transactions entered into by Canadian market participants will be with a non-Canadian counterparty.

[3] Total notional amount of global OTC derivatives contracts at the end of June 2016 was USD 544 trillion. See "Statistical release OTC derivatives statistics at end-June 2016", Bank for International Settlements, November 2016 at pg. 11, available here, converted to CAD 701.76 trillion using the June 30, 2016 exchange rate of 1.29 found here. The Canadian OTC derivatives market is estimated at CAD 30 trillion for Q2 2016. See "Toward More Resilient Markets: Over-the-Counter Derivatives Reform in Canada", Bank of Canada Financial System Review, December 2016 at page 54, available here.

[4] Letter dated June 17, 2013 from Katherine Darras, General Counsel, Americas, International Swaps and Derivatives Association, Inc. ("**ISDA**"), page 4. Available here.

> regulations do not restrict the ability of Canada market participants to continue participating in, and remaining competitive in, the global OTC derivatives market. To this end, ISDA cautions regulators against adopting duplicative, overlapping or incremental requirements and/or infrastructure where sufficient alternatives exist. For example, regulators should consider whether it is appropriate to establish a Canadian registration requirement when there is no requirement to register under the European Market Infrastructure Regulation ("EMIR")[5] and registration is not a G20 obligation. Moreover, regulators should bear in mind the more limited number and types of counterparties participating in the Canadian market, as well as products traded, when compared to other foreign markets. The only other country with an OTC registration requirement comparable to [the] Committee's proposal is the United States, which is a market of a size, diversity and liquidity that does not compare to that of the Canadian market. Furthermore, the United States' OTC derivatives registration regime includes a number of exemptions and thresholds that have not been incorporated, in whole or in part, in the Committee's proposal. We further note that other jurisdictions of comparable size and participating counterparty types, such as Australia, have not imposed local registration requirements for the OTC derivatives market. In addition, none of the Asian jurisdictions have adopted derivatives registration regimes similar to, or as fulsome as, the Committee's proposal.
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> Many Canadian counterparties have, therefore, expressed concerns that a registration regime may make participation in the Canadian market too burdensome or expensive in particular for foreign derivatives dealers, with the result that Canadian market participants may face a dwindling number of counterparties willing to transact in Canada. [Emphasis added.]

Any registration regime for Canada needs to take into account the global nature of the OTC derivatives market and preserve liquidity and access while protecting smaller market participants. Otherwise, the registration regime, as currently drafted, will disrupt the OTC derivatives market in Canada and will create systemic and economic risk instead of reducing it. CMIC urges that the following approach be adopted: (1) exclude Canadian financial institutions that are prudentially regulated by the Office of the Superintendent of Financial Institutions ("**OSFI**") from the application of the Proposed Rules, and (2) exclude all foreign dealers and advisers from any jurisdiction from the Proposed Rules subject to the conditions set out below.

Canadian Financial Institutions

CMIC strongly urges the CSA to exclude FRFIs from the application of the Proposed Rules, without needing to satisfy any conditions, other than to be prudentially regulated by OSFI. For clarity, this exclusion means that FRFIs would not have any obligations under the Proposed Rules nor would any of the obligations under the Proposed Rules apply to derivatives dealer counterparties of a FRFI including, without limitation, the requirement to provide access to a FRFI's books and records. This exclusion (i) is appropriate and supported by IOSCO principles, (ii) is consistent with investor protection goals, (iii) is necessary for ongoing effective prudential regulation and (iv) is necessary to ensure the stability and proper functioning of provincial and national economies, and the Canadian OTC derivatives market as a whole. These four aspects are discussed in greater detail below. In addition, following this discussion, we describe a particular issue with respect to FRFIs and the

[5] Since the date of the ISDA letter, other jurisdictions, including Europe and Hong Kong, have implemented a registration or licensing regime, however, with the exception of the U.S., they are all general regimes that capture a range of financial activities and are not specific to OTC derivatives products. *Review of Implementation Progress in Regulation of Derivative Market Intermediaries,* Report of the Board of the International Organization of Securities Commissions. July 2015, page 13-16, available here.

proposed requirement to provide prescribed supervisory information to provincial securities regulators.

(i) Exclusion is appropriate and consistent with IOSCO principles

The IOSCO DMI Report expressly recognizes that, where a designated market intermediary is subject to equivalent requirements by its prudential regulator, it should not be subject to registration or licensing.[6] IOSCO has asserted that the regulation of derivatives market intermediaries "should be primarily focused on areas where capital, counterparty or client money and public confidence may be most at risk."[7] These three objectives are already addressed by existing regulation of FRFIs. Any risk associated with OTC derivatives transactions by FRFIs is addressed by OSFI's capital guidelines; and any concerns relating to counterparty or client money delivered to a FRFI are addressed under OSFI Guideline E-22 Margin Requirements for Non-Centrally Cleared Derivatives and the CSA rules under National Instrument 94-102: *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions.* We further note that OSFI prudentially supervises the business of a FRFI, including its foreign branch activity. Finally, with existing OSFI guidelines, there has been no loss of public confidence with respect to a FRFI, nor an inability of OSFI to enforce the proper conduct, in the Canadian OTC derivatives market. The existing framework is appropriate to ensure that public confidence is maintained in the future. Even beyond these three areas of primary focus, OSFI's standards are consistent with IOSCO standards and recommendations that support the CSA's objectives in the Proposed Rules.

(ii) Investor protection goals satisfied

Existing OSFI guidelines and legislation provide a comprehensive compliance and protection regime for counterparties facing FRFIs in OTC derivatives transactions. We refer you to Schedule A to this letter which indicates how, on an outcomes basis, the existing regulatory regime for FRFIs achieves the same objectives as the Proposed Rules. We have also considered the issue of whether OSFI's statutory powers include the ability to penalize individuals for failure to comply with OSFI requirements. It is clear that OSFI does have such powers. This insight places prudential regulation on a similar enforcement footing with CSA rules, further supporting our conclusion that compliance by a FRFI subject to OSFI guidelines is equivalent to compliance by a FRFI with the applicable Proposed Rules. Accordingly, the CSA's investor protection goals are not compromised if FRFIs are excluded from the scope of the Proposed Rules. We further note that the CFTC determined that OSFI's standards are generally identical in intent to certain similar CFTC requirements and, on that basis, determined that they were comparable to and as comprehensive as those CFTC requirements. This further demonstrates that OSFI's comprehensive and robust framework, which has not been challenged as deficient, is sufficient and effective. It would be perverse if a foreign regulator, such as the CFTC, accepts OSFI standards as sufficient, but provincial regulators did not.

(iii) Exclusion is necessary for effective prudential regulation

The current formulation of the Proposed Rules will impede the mandate of prudential authorities, whether they be provincial or federal, by providing a securities regulator in one province with authority to make decisions that could have a profound impact on the economy in another province. The

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[6] *International Standards for Derivatives Market Intermediary Regulation,* Final Report of the Technical Committee of the International Organization of Securities Commissions ("**IOSCO**"). June 2012 at page 13, available here (the "**IOSCO DMI Report**"), page 13.

[7] *Ibid,* page 1.

concern is that securities regulators do not have a mandate to consider those decisions from a micro prudential or systemic perspective. For example, if an institution that is important to the Quebec economy were not in full compliance with securities laws, a securities regulator such as the Alberta or British Columbia Securities Commission would not have the mandate to consider the broader impact of its enforcement action on the Quebec economy. If a regulator suspends the institution's registration in those provinces or notifies the public of enforcement action[8], this could precipitate a crisis of confidence in that important Quebec institution by publicizing issues that OSFI or the AMF, as prudential regulators, may be attempting to resolve privately in order to retain confidence and achieve recovery of the institution. Such action would also have knock-on contractual effects. For example, section 5(d) of LCH Limited's ("**LCH**") default rules provides that suspension of registration (even one that is not material to the institution) is a default trigger.[9] If an institution does not have access to LCH, this will certainly derail resolution plans. In addition, suspension of registration could be an event of default under that institution's ISDA master agreements. This will make it more difficult, if not impossible, for the institution to hedge its banking book and continue to provide banking services. The institution would not even be able to hedge as an end user wherever the suspension has effect because the end-user exemption is not available to registered dealers. The crucial point is that efforts by prudential regulators to bring about a recovery of the institution or to engage in an orderly wind-down are placed at risk under current formulation of the Proposed Rules. While passporting will make this regime more efficient, it will not solve this fundamental problem because each province (being sovereign) will always retain an opt-out right from a passporting regime and could then take independent enforcement action. While what is outlined above is a worse-case scenario, FRFIs engage in extensive efforts to preclude it from happening by engaging in extensive recovery and resolution planning, as mandated by OSFI and Canada Deposit Insurance Corporation. This includes efforts to ensure continued access to the OTC derivatives market in such situations. Therefore, it is prudent for the Proposed Rules to consider all scenarios and their potential impact. Excluding FRFIs from the application of the Proposed Rules will address these crucial issues.

(iv) Exclusion is necessary to avoid detrimental effect on the Canadian OTC derivatives market

Granting an exclusion to FRFIs is beneficial to the Canadian OTC derivatives market in four ways: it (a) places FRFIs on a more level playing field with foreign banks, (b) harmonizes the Canadian registration regime with the regimes in other jurisdictions with an OTC derivatives market that is similar in size to Canada, (c) avoids material risk that domestic liquidity will be reduced in certain jurisdictions if a FRFI is required to register in every province and territory of Canada and (d) reduces the material risk that foreign dealers will exit the Canadian market because they will not want to be exposed to the knock-on contractual effects facing FRFIs as described immediately above under paragraph (iii) "*Exclusion is necessary for effective prudential regulation*".

(a) As currently drafted, we understand that the Proposed Rules are intended to apply to a foreign dealer transacting with a foreign branch of a Canadian bank.[10] This means that, for example, a Japanese bank trading with the UK branch of a Canadian bank would be subject to the Canadian registration rules, even though neither the booking locations nor the location of the traders are in Canada. Even more problematic, once a Japanese bank is registered, there is nothing in the Proposed Rules that would then preclude the Proposed Rules from applying in respect of all the Japanese bank's global trading, for example, registration of individuals, Canadian specific exams, and

[8] A securities regulator may take such action based on the determination that it would be in the public interest to do so in that particular province.

[9] Available here.

[10] We discuss the implications of this broad jurisdictional reach below under the section, "Extraterritorial Scope" on page 8.

requirement for a written agreement, even if they are only trading with Japanese counterparties. Even if the Japanese bank qualified for an exemption from registration under the Proposed Rules, it would still need to satisfy the conditions to such exemption, including providing Canadian regulators unfettered access to its books and records, even information that does not relate to trades with Canadian counterparties. In such circumstances, it is very difficult to see why the Japanese bank would choose to transact with the Canadian bank and accept legal and regulatory liability when it could, instead, choose another counterparty that is not subject to the Proposed Rules.

(b) Excluding FRFIs from the application of the Proposed Rules will promote harmonization with global rules. As mentioned above, the only other jurisdiction with such a widespread registration regime is that of the United States under the CFTC regime. Given the dramatic difference between the size of the Canadian OTC derivatives market relative to the U.S. market, a more appropriate comparison for derivatives dealer registration purposes is to the Australian market. In Australia, CMIC understands that there is no derivatives dealer registration regime, nor is one proposed. Even a larger market, such as the Hong Kong OTC derivatives market is proposing a more balanced regime. CMIC understands that the Hong Kong Securities and Futures Commission (**SFC**) proposes a "Type 11" licensing regime for OTC derivatives which will exempt Hong Kong Monetary Authority (HKMA) regulated firms. Specifically, HKMA regulated Authorized Institutions (AI, firms licensed to carry on the business of taking deposits) and Approved Money Brokers (AMB, persons in the business of arranging agreements between AIs and other entities for making deposits and the purchase/sale of financial instruments) will be exempt from the requirement to be licensed.[11]

The CSA has consistently articulated that the Canadian OTC derivatives regulatory regime should be harmonized with global standards. Yet, with respect to the issue of registration, the proposed regime is not harmonized with markets of similar size. By excluding FRFIs from the application of the Proposed Rules, as long as such FRFIs are prudentially regulated by OSFI, the Canadian regime will be harmonized with appropriate foreign derivatives markets.

(c) In CMIC's view, there is a material risk that domestic liquidity will be reduced if FRFIs are required to register in every single province and territory of Canada. Based on an anonymized survey (aggregated by counsel) of the majority of sell-side CMIC members to determine the number of counterparties each such member has in each province and territory, there are a number of banks that have fewer than 40 counterparties in some provinces and territories, and in some of them, fewer than 10 counterparties. Accordingly, it will become disproportionately more expensive to do business in those jurisdictions which may translate into a market access issue if the cost of hedging transactions increases for end-users in those jurisdictions. Excluding FRFIs from the application of the Proposed Rules would mean that there would be no significant reduction in domestic liquidity. We discuss this issue further under the heading "De Minimis Threshold Exemption".

(d) As described in the previous section (*Exclusion is necessary for effective prudential regulation)*, under the proposed regime, provincial securities regulators would be empowered to issue cease trading orders in respect of a FRFI's OTC derivatives trading business even though provincial

[11] 2012 HKMA and SFC joint consultation paper, at para 54, available here. See also 2015 circular to OTC derivatives market participants on new derivatives regulation, available here: "When the OTC derivatives licensing regime commences, corporations intending to engage in a business in Hong Kong in dealing in or advising on OTC derivative products, providing client clearing services for OTC derivatives transactions, managing portfolios of OTC derivative products, and/or providing automated trading services (ATS) for OTC derivatives transactions, will need to be licensed or registered for the new and/or expanded RA(s) unless exempted. [6] Authorized institutions (AIs) and approved money brokers [7] will be exempted under certain circumstances, and their OTC derivatives activities will be overseen and regulated by the HKMA."

securities regulators do not have jurisdiction to consider decisions from a prudential perspective. The concern is that action might be taken by a provincial securities regulator that has a detrimental effect from a prudential and systemic risk perspective, as well as from the perspective of the overall regulation of the FRFI. As noted above, such an action would have very serious knock-on effects, such as the ability of LCH to trigger an event of default under its rules, even if such cease trading order is not material to the FRFI.[12] Further, the standard ISDA master agreement includes an agreement to maintain all governmental consents which are required in order to perform its obligations under such agreement, as well as an agreement to comply in all material respects with applicable laws and orders where failure to so comply will impair its ability to perform its obligations under such agreement. Some ISDA agreements have been amended to include a cross-default to any derivatives transaction. A cease trading order could therefore give any counterparty, including a foreign counterparty a right to trigger an event of default against a FRFI. While terminating its ISDA against a FRFI is optional in such circumstances, the concern is the uncertainty of what other foreign dealers will do and the effects on the creditworthiness of the FRFI if one other foreign dealer triggers a default under its ISDA agreement. Liquidity in the Canadian OTC derivatives market will be substantially reduced if foreign dealers decide that they do not wish to assume the legal risk and liability of trading with a counterparty that is subject to these knock-on effects.

Information Given to Regulator: The CSA should not have access to a FRFI's books and records as a condition of excluding FRFIs from the application of the Proposed Rules. The concern is that effective prudential regulation is achieved through an understanding of the Canadian approach to financial institution regulation, the specific industry issues that are faced by the financial institutions and the individual financial institution's history within that framework. Isolating specific risk or reporting to a securities regulator is contrary to the established view that an appropriate regulatory system is already in place for the activities of FRFIs, and runs the risk that the unconsolidated complete information provided to the securities regulator is misinterpreted. In addition, if the CSA were to have unfettered access to a FRFIs books and records, such access might mean providing the provincial regulators with prescribed supervisory information (**PSI**), depending on the specific circumstances. For example, Section 27(3)(d) provides that the derivatives ultimate designated person is required to report on a timely basis to the provincial regulator where the derivatives firm is not, or was not, in compliance with NI 93-102 or securities laws. There are other similar requirements under NI 93-102, such as: Section 56(b) (requires a FRFI to notify the regulator of each instance of material non-compliance with a requirement or guidance to which it is subject), Section 42(4) (unresolved disputes that continue for 30 days to be reported to the regulator), Division 2 of Part 7 (audits) and Part 9 (records). Information provided to the CSA under these sections could well include PSI depending on the specific circumstances. Some of these record keeping provisions relate to the prudential aspect of record keeping (e.g. business and strategic planning; audit, compliance and risk management; minutes of meetings with Board of Directors). The reason for the concern is that PSI is protected under federal law and FRFIs are prohibited from sharing such information with anyone, including provincial regulators.[13] It would be an offence under federal law for an FRFI to do so. FRFIs can only provide this information to OSFI and it is OSFI's decision as to what information may be shared with provincial regulators. This strict federal prohibition on disclosure of PSI is a long standing feature of federal law that is designed to allow federal prudential and systemic regulators to mitigate and manage systemic risk. Accordingly, access to a FRFI's books and records cannot be a condition of excluding FRFIs from the application of the Proposed Rules as it would be a contravention of federal law.

[12] Supra, note 9.

[13] Supervisory Information (Banks) Regulations, SOR-2001-59 under *Bank Act* (Canada). There are equivalent regulations under federal legislation applicable to other types of FRFIs.

Harmonized Implementation: One simple way to implement our proposal to have a complete exclusion for FRFIs would be to replicate in the derivatives registration rule for all CSA members an exemption from the derivatives dealer and adviser registration requirements that is comparable to the exemption from the registration requirements of securities legislation that is found in Section 35.1 of the *Securities Act* (Ontario). Exemptive relief that is similar to the exemption that has been granted by Section 35.1 has also been granted by a number of other provincial jurisdictions pursuant to blanket orders and derivatives legislation for the express purpose of exempting OTC derivatives transactions entered into between certain institutional investors, including FRFIs, from applicable dealer registration requirements.

Ontario proposes to broaden the application of Section 35.1 pursuant to amendments to the *Securities Act* (Ontario) that have already been passed, but have not yet been proclaimed in force. Once proclaimed in force, these amendments to the definitions of "dealer" and "adviser" would serve to exempt FRFIs from derivatives dealer and adviser registration requirements as well as the registration requirements of securities legislation. If an exemption comparable to Section 35.1 could be adopted as part of the derivatives registration rule, it would serve to establish an exclusion for FRFIs that would be harmonized throughout all jurisdictions of Canada.

Foreign Dealers

The main source of liquidity in the Canadian OTC derivatives market comes from foreign dealers. It is therefore imperative that the Proposed Rules and the Proposed Business Conduct Rule do not increase legal and regulatory compliance risk to foreign dealers, such that the commercial opportunities in the Canadian OTC derivatives market outweigh the costs and compliance burden. Further, additional costs and legal burden should not be imposed on foreign derivatives dealers if the Proposed Rules and Proposed Business Conduct Rule are not necessary to achieve the goal of protection of investors. CMIC proposes the following approach, which is a modified version of the international dealer exemption in the securities market and which will minimize foreign dealers exiting the Canadian OTC derivatives market: (1) exclude the application of the Proposed Rules to foreign dealers if they only transact with a FRFI, and (2) provide an exemption from registration for foreign dealers with certain conditions, in each case, regardless of where such derivatives dealer's head office or principal place of business is located. Although the securities market and the OTC derivatives market are different, this recommendation has precedence in the securities market[14] and accordingly, the CSA should be comfortable taking this approach. We note, however, that even though the approach taken in the securities market includes certain conditions, it is imperative that there are no conditions imposed with respect to foreign derivatives dealers other than, in the case of (2) only, the requirement that (i) the foreign derivatives dealer is registered, exempt from registration or otherwise permitted to carry on the business of a derivatives dealer in its home jurisdiction and it engages in the business of a derivatives dealer in such jurisdiction, (ii) the foreign derivatives dealer only transacts and deals with EDPs (subject to our comments below on page 13 regarding the definition of EDPs and specifically, the fact that every eligible contract participant must be an EDP), and (iii) the foreign derivatives dealer must, subject to bank secrecy, privacy, data confidentiality and other similar laws, provide the applicable regulator access to its books and records only with respect to OTC derivatives transactions entered into with Canadian counterparties in such regulator's jurisdiction, and only if such regulator has reasonable grounds for believing that such foreign dealer has violated applicable Canadian laws.

[14] See Section 8.18 of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

While such a condition to provide unfettered access to books and records might be commonplace in the securities market, this is another area where the derivatives market is significantly different. The business of trading securities is generally conducted through a special purpose subsidiary. As a result, access to the books and records of a securities dealer is generally limited to books and records in relation to the securities dealing business that is conducted by the subsidiary. In the case of OTC derivatives transactions, it is currently proposed that access to the books and records of derivatives dealers would be much more broadly cast and would not be limited to books and records in relation to such transactions. In addition, unlike OTC derivatives transactions, the business of trading securities involves the intermediation of client trading activity on both a principal and agency basis. Access to a securities dealer's books and records is therefore intended to afford securities regulators with a means of monitoring the relationship that exists between a securities dealer and its clients. This access rationale is not applicable to OTC derivatives transactions between EDPs because such transactions are the product of arm's length negotiations between sophisticated parties. Furthermore, given the importance of addressing the credit risk inherent in OTC derivatives transactions, and also to take advantage of close-out netting, derivatives dealers generally enter into OTC derivatives transactions through their parent bank (where applicable). Accordingly, submitting to the jurisdiction of CSA members and allowing the CSA complete access to books and records of the parent bank would, in CMIC's view, be unprecedented and seen as a large deterrent to foreign banks entering into transactions in the Canadian OTC derivatives market. We note that even though CFTC regulations provide for access to books and records of swap dealers, our understanding is that, through discussions with OSFI, this access in practice may be subject to certain informal limitations, particularly in relation to non-US related records. For these reasons, the proposed reformulated foreign derivatives dealer exemption should not allow the CSA to have unfettered access to the books and records of the foreign derivatives dealer.

Exempting all foreign derivatives dealers is critical to maintaining liquidity in the Canadian OTC derivatives market. There will be costs as well as legal and regulatory compliance risk to foreign derivatives dealers which will be disproportionate to the benefits to those foreign derivatives dealers of remaining in the Canadian OTC derivatives market given the relatively small size of the market. In fact, it has been the recent experience of CMIC members that certain foreign market participants have been willing to voluntarily remove access by Canadian market participants because of the complicated Canadian regulatory landscape. With this reformulated foreign derivatives dealer exemption, disruption caused by the Proposed Rules to the Canadian OTC derivatives market will be reduced somewhat. Non-EDPs will be protected since the exemption won't be available to foreign derivatives dealers when transacting with non-EDPs. Accordingly, this recommendation strikes the balance between retaining a liquid Canadian OTC derivatives market and protecting market participants that the CSA are concerned about protecting.

EXTRATERRITORIAL SCOPE

International regulators have recognized the global inter-connectedness of the derivatives market and the necessity that regulators consider the impact of their choices on market efficiency and competition, which are vital to a well-functioning global derivatives market[15]. These considerations are particularly acute for a smaller derivatives market such as Canada. We must avoid an unintended negative impact on the market. Even larger derivatives markets such as Hong Kong and Singapore have been careful to avoid duplicative regulatory regimes as described below.

[15] Commodity Futures Trading Commission, "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements", 17 CFR Part 23 at 34820. Available here.

The Proposed Rules provide that registration is required if an entity carries on business as a derivatives dealer or derivatives adviser "in a local jurisdiction". It is CMIC's understanding that the CSA interprets the phrase "in a local jurisdiction" to include the jurisdiction(s) in which a party's head office and principal place of business are located. With respect to a non-derivatives dealer, CMIC agrees with that interpretation.[16] However, it would be consistent with international regulators' approach to extraterritoriality, principles of comity and minimizing market disruption if the CSA also confirm that when a derivatives dealer (whether or not organized in Canada) transacts through an office or branch outside of Canada with a counterparty that is not organized in Canada, neither counterparty would be subject to the Proposed Rules in respect of those transactions. "Transacting" in this context, with respect to a derivatives dealer, would refer to the location of front-office sales and trading personnel who are interacting with the counterparty. This would give the Canadian derivatives market the certainty and predictability it needs to function well.

Further, it is CMIC's understanding that the CSA may interpret the phrase, "in a local jurisdiction" differently depending on whether the phrase is being used in the context of the Proposed Rules or the Proposed Business Conduct Rule. The interpretation of this wording should be consistent among all derivatives rules. Otherwise, it would be confusing for market participants and such confusion could lead to increased costs of doing business in Canada and, if the uncertainty is too high, it will likely cause participants to exit the OTC derivatives market in Canada.

A derivatives dealer's head office and principal place of business should not be determining factors in identifying in which jurisdiction to register and which province's rules apply. Otherwise, Canadian banks and other domestic derivatives dealers trading from non-Canadian jurisdictions, will be placed at a disadvantage vis-à-vis its global competitors. Liquidity for sell-side Canadian counterparties will significantly decrease if jurisdiction under Canadian rules is determined solely by the location of a party's head office or principal place of business. [17] It would be unfortunate (and particularly damaging to the Canadian OTC derivatives market) if the CSA were to repeat the extraterritorial mistakes made by, and now acknowledged as such, by the CFTC.[18] In such circumstances, local laws should govern any registration and business conduct requirement as those are the laws with the closest nexus to the transaction. It cannot be overstated that the current formulation of the foreign dealer and foreign adviser exemptions under sections 52 and 59 will not address these issues. The conditions attached to such exemptions are not appropriate in the global OTC derivatives market. Given the bespoke nature of certain provisions contained in both the Proposed Rules and the Proposed Business Conduct Rule, such as the senior manager and fair dealing obligations, as well as the derivatives ultimate designated person ("**UDP**"), chief risk officer ("**CRO**") and chief compliance officer ("**CCO**") provisions, CMIC is not confident that the CSA will find, on an outcomes basis, that the rules of a particular jurisdiction are equivalent. In fact, we note that the CSA does not even view OSFI's guidelines as being sufficient based on the way Appendix F of the Proposed Rules is currently populated; a view with which CMIC firmly disagrees.[19]

Another example of how an interpretation of the jurisdiction of a derivatives dealer under the Proposed Rules based on head office or principal place of business would be disruptive can be seen

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[16] If a derivatives dealer trades only with unknown counterparties, the head office or principal place of business will also be unknown and therefore, the Proposed Rules and the Proposed Business Conduct Rule would not apply.

[17] CMIC notes that even the CFTC has acknowledged that US banks' non-US branches do not have to adhere to the Dodd-Frank business conduct standards when transacting with non-US counterparties as long as the notional amount of such trades don't exceed 5% of the swap dealer's aggregate notional derivatives activity (although this cap doesn't apply to trades with clients in Canada, Australia, HK, Japan, Switzerland and the EU). Given the size of the U.S. market compared with the Canadian market, CMIC does not support the CFTC interpretation of jurisdictional reach, however, we note this one aspect of CFTC rules just to demonstrate that even the CFTC has implemented some restriction on its extraterritorial jurisdiction.

[18] See CFTC Chairman Giancarlo's September 4, 2018 speech to the City of London (available here).

[19] See Schedule A to this letter for CMIC's view on how existing legislation and OSFI guidelines are equivalent to the requirements under the Proposed Rules.

by looking at Canadian banks' private banking client business. Currently, Canadian banks transact OTC derivatives with private banking clients in foreign jurisdictions through foreign branches and are subject to, and comply with, local laws. For example, clients in Hong Kong and Singapore where individuals in those jurisdictions are subject to minimum thresholds of financial assets of SGD $2 million (roughly CAD 2 million) and HKD $8 million (roughly CAD 1.3 million). Local law also requires that clients have derivatives knowledge and that the bank perform suitability assessments by considering the client's risk profile, investment needs and relative product features. In addition, risk disclosures are provided to the clients. Local regulators are in the best position to determine the appropriate standards in the markets that they regulate. Further, local prudential laws and bankruptcy laws would also apply to such foreign branch and its activity in such jurisdictions. Based on information currently available to one CMIC Canadian bank member, it estimates that approximately half of the individuals that trade with it through its private banking client division would likely not meet the EDP threshold. However, that bank may not necessarily have information regarding financial assets that are not managed by it and therefore would need to perform a client outreach to determine whether clients are EDPs. Obtaining responses from clients to an outreach request is very difficult, especially from non-Canadian clients as it relates to Canadian regulatory matters. In particular, it has been the experience of CMIC members that it has been problematic obtaining representations from private banking clients (indeed, any client) if other private banks and other counterparties have not requested similar information, as such clients often transact with multiple banks. Canadian counterparties will be placed at a competitive disadvantage in foreign markets, which is particularly concerning given the global nature of OTC derivatives market. Accordingly, the Proposed Rules should not be applicable in circumstances where a derivatives firm is transacting or advising from a non-Canadian jurisdiction with a derivatives party located in a non-Canadian jurisdiction because, as it relates to the derivatives transactions of that derivatives party, there is no meaningful nexus to Canada. In such circumstances, the derivatives dealer, and the individual acting on behalf of the derivatives dealer, would need to comply with the local laws of the jurisdiction in which it and the derivatives party are located. In addition, if the derivatives dealer is subject to OSFI oversight, the foreign branch will fall under OSFI's jurisdiction even though the foreign branch is located in a foreign jurisdiction and the counterparty is a non-Canadian. In CMIC's view, there would be no benefit of imposing the Proposed Rules and the Proposed Business Conduct Rule, and the associated administrative burden of a client outreach, on derivatives parties in jurisdictions where local laws already provide sufficient protection.

If a foreign derivatives dealer wishes to avoid registration, it could enter into OTC derivatives out of its Schedule III bank with counterparties "located in" Ontario. If the location of the head office or principal place of business (the "**Home Jurisdiction**") will always be applicable when facing a counterparty, such Schedule III bank will only choose Canadian banks whose head office and principal place of business are located in Ontario. Otherwise it would be subject to registration. Accordingly, such an interpretation of whether a person or company is "in a local jurisdiction" will place FRFIs who have their head office or principal place of business in Ontario at an advantage. This would not be a 'level playing field'. This interpretation should not prevail and, instead, the only jurisdiction(s) that should be relevant in determining whether a derivatives dealer is "in a local jurisdiction" are the location(s) of the front-office sales and trading personnel of the derivatives dealer who are interacting with the counterparty.

We understand that the reason why the CSA has interpreted jurisdictional scope based on head office or principal place of business is that it is concerned about regulating activities undertaken in foreign jurisdictions by an entity incorporated under Canadian law, and protecting "investors" in those foreign jurisdictions. This is over-reaching by the Canadian regulators and inconsistent with the approach taken in the securities market. For example, OSC Rule 32-505 is an example of a rule where Canadian provincial regulators defer to the securities laws of a foreign jurisdiction. Sections 2.1(b) and 2.3(a) of OSC Rule 72-503 *Distributions Outside Canada* are additional examples, particularly Section 2.3 as it allows reporting issuers to make a distribution of their securities outside Canada so long as they materially comply with any applicable foreign disclosure obligations (without reference to any specific foreign jurisdiction). It is therefore unclear to CMIC why the CSA believes they are in a better position than foreign regulators to assess what protections foreign market participants need in the OTC derivatives market.

Finally, CMIC notes that if a foreign dealer is subject to the requirements under the Proposed Rules or the Proposed Business Conduct Rule, the obligations under the Proposed Rules should apply to its dealings with Canadian counterparties only, and not to the foreign dealer's entire organization or all transactions it enters into.

Significant impact on real-economy companies and significant uncertainty remains regarding the application of the Proposed Rules. Concentrating market risks, reducing market liquidity, and increasing costs associated with prudent risk management would unnecessarily hinder Canadian business growth and negatively affect the Canadian economy without any tangible reduction in systemic risk.

For the above reasons, CMIC urges the CSA to interpret the phrase "in a local jurisdiction" to mean, in respect of non-derivatives dealers, the head office or principal place of business is located in a local jurisdiction, and for derivatives dealers, the front office sales and trading personnel who are interacting with the counterparty and are located in the local jurisdiction.

LIQUIDITY/ACCESS

<u>Bespoke Regulations</u>

The Canadian derivatives market represents only a very small part (approximately 4%) of the global derivatives market, and in excess of 80% of all trades with Canadian banks involve foreign counterparties, based on the notional amount of such derivatives. These Canadian derivatives market characteristics mean that preserving liquidity and access to dealers and advisers is essential for Canadian businesses to be able to hedge the risks associated with their operations. Introducing bespoke regulatory requirements, such as the requirement to designate a derivatives ultimate designated person, a derivatives chief compliance officer and a derivatives chief risk officer, will compromise existing liquidity and access because the added regulatory burden will deter both foreign and domestic dealers and advisers from maintaining Canadian operations. Indeed, IOSCO[20] cautions against bespoke regulation by stating the following:

> Given the global nature of the market, the effectiveness of the risk mitigation requirements could be undermined if inconsistent requirements are adopted. Inconsistent or conflicting requirements also would add to the regulatory burden and costs of compliance for the industry. Authorities should cooperate and coordinate through bilateral or multilateral channels to reduce such issues to the extent possible.

Compromising liquidity and access will create systemic risk[21] and have economic consequences that are harmful and unnecessary. The Proposed Rules, especially when combined with the Proposed Business Conduct Rule, would result in serious and dangerous curtailment in domestic and cross-border liquidity in the Canadian derivatives market.

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[20] *Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives,* Report to the Board of the International Organization of Securities Commissions, January 28, 2015 at page 17, available here.

[21] Note that the Supreme Court of Canada states in Reference Re: *Securities Act*, 2011 SCC 66 at [120] and [121] that systemic risk regulation is beyond the capacity of a specific province because it is a national matter that requires the national reach of federal authority.

We have attached as Schedule B to this letter a comparison of the IOSCO recommendations with respect to the regulation of DMIs as set out in the IOSCO DMI Report against certain sections of the Proposed Rules to highlight areas where the Proposed Rules go beyond what is recommended by IOSCO. In addition, Schedule B contains a comparison of certain sections of the Proposed Rules with recommendations from IOSCO under its report relating to Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives.[22] CMIC is very concerned that Canadian derivatives market liquidity and access will be significantly reduced if CMIC's recommendations regarding the exclusion of FRFIs and reformulation of the foreign dealer and adviser exemptions are not accepted and the Proposed Rules diverge from IOSCO recommendations. It has been the experience of CMIC members that certain foreign market participants do not find that the benefit of changing and expanding their systems and processes in order to accommodate unique Canadian rules outweighs the costs and burdens thereof. This leads to material liquidity and access compression.

In addition to the issues raised above under "Exclusions" and "Extraterritorial Scope", the following sections of the rule will also lead to decreased liquidity and access in the Canadian OTC derivatives market: (a) current definition of "eligible derivatives party", (b) current approach to the *de minimis* threshold exemption, (c) the lack of a passporting regime for derivatives dealer and adviser registration, (d) the listing of clearing intermediaries as an additional registration trigger, (e) requiring registered foreign derivatives dealers to report all their transactions globally under Ontario, Manitoba and Quebec trade reporting rules, (f) requiring signed written agreements for transactions with unknown counterparties and (g) the requirements relating to the registration of derivatives advisers. We will discuss each of these issues below.

(a) <u>Eligible Derivatives Party Definition</u>

As discussed in greater detail in our Business Conduct Response Letter CMIC urges the CSA to amend the definition of "eligible derivatives party" to:

- remove the financial threshold for commercial hedgers in paragraph (n);
- lower the financial threshold in paragraph (m) for a non-individual from net assets of $25 million to total assets of $10 million; and
- remove the knowledge and experience requirement under paragraphs (m), (n) and (o).

The definition of EDP is an even more crucial matter under the Proposed Rules than under the Proposed Business Conduct Rule since the exemption from registration for foreign dealers and advisers under Sections 52 and 59 is conditional upon the foreign dealer or adviser only dealing with or advising EDPs. If a derivatives party is not an EDP, foreign dealers and advisors will choose not to deal with such a derivatives party, instead of registering as a derivatives dealer or derivatives adviser under the Proposed Rules. Many foreign dealers are registered swap dealers under CFTC rules and therefore are currently required to only deal with eligible contract participants. Unless every eligible contract participant is an EDP, we believe that foreign dealers will withdraw from the Canadian OTC derivatives market, instead of changing their current compliance procedures and systems to determine whether existing derivatives parties are EDPs. The alternative of registering will not be acceptable to the foreign derivatives dealer. Accordingly, it is even more critical to the issue of liquidity and market disruption that every eligible contract participant satisfy the definition of an EDP.

This issue is also crucial for individuals acting on behalf of domestic derivatives dealers and advisers who wish to qualify for the exemption under Sections 16(3) and (4) of the Proposed Rules. Many of the derivatives parties that are currently trading with derivatives dealers, or being advised by

[22] *Infra,* note 19.

derivatives advisers, under the hedger category of the definition of accredited counterparty under the Quebec Derivatives Act and under the definition of qualified party under the rules of other provinces, such as BC and Saskatchewan, would not satisfy the definition of EDP as currently drafted. In fact, based on best available data and without the benefit of a client outreach, at least one Canadian bank member of CMIC estimates that approximately 90% of their existing mid-market OTC derivatives client base will not qualify as an EDP under the current formulation. Another Canadian bank member of CMIC estimates that almost all of its mid-market FX clients will not qualify as an EDP under the current formulation. If an individual wishes to continue trading with or advising such non-EDPs, he or she will need to be registered. Accordingly, individuals may no longer wish to deal with, or advise, such non-EDPs once the Proposed Rules comes into effect. Therefore, the threshold amount currently in the commercial hedger category should be removed.

(b) *De Minimis* Threshold Exemption

Threshold level:

It is not clear to CMIC why there are two different threshold levels – one only for commodity derivatives and another for all other derivatives. No explanation was provided in either the CSA notice or the Companion Policy. Canada would be offside other jurisdictions, such as the CFTC rules, with respect to this point.

CMIC is very concerned that the threshold level(s) could be too low, especially when compared with the U.S.$8 billion threshold under CFTC rules. It is not clear why such a low level was selected, in particular, the Canadian $250 million level. If that level was chosen in order to ensure that certain types of dealers do not fall under the threshold (and therefore qualify for the exemption), CMIC recommends that, instead, those types of entities should be listed under Section 6 of the Proposed Rules (Additional Registration Triggers). Clearly, only the CSA has comprehensive trade data in which to inform its decision as to this *de minimis* threshold level. However CMIC recommends that the CSA should be transparent in its process and analysis of the data and how it determined that these levels were appropriate. For example, CMIC strongly recommends that the CSA produce an analysis similar to what the CFTC has conducted whereby it discloses how many market participants would be required to register at certain threshold levels as compared with the additional trading volume captured if threshold levels were lowered.[23] Without having the benefit of the CSA's analysis or the trade data, CMIC recommends that the CSA reconsider the levels, bearing in mind the following points:

- the threshold level should not be too low, otherwise small and mid-sized market participants will exit the Canadian OTC derivatives market, driving business to the big banks, thereby concentrating increased systemic risk;

- low thresholds could impede the willingness of foreign banks to trade with Canadian banks, leading to a reduction in liquidity (note, however, that should the Inter-dealer Exemption strongly recommended above be granted, that exemption would address this concern); and

- while the calculation in the Proposed Rules has the benefit of being straight forward to calculate, it would be appropriate and more reflective of risk being undertaken if dealers would be able to exclude certain items from the determination of outstanding notional amount. For example, similar to the exemptions under the CFTC rules, exemptions from the calculation could be provided for loan hedging activity,

[23] Swap Dealer *De Minimus* Exception Final Staff Report, a report by Staff of the U. S. Commodity Futures Trading Commission pursuant to Regulation 1.3(ggg), August 15, 2016, at page 23. Available here.

transactions entered into to hedge physical or financial positions and transactions resulting from multilateral portfolio compression exercises. Therefore, even though the calculation would not be as simple, because many market participants are already performing this calculation for CFTC purposes, adding these exemptions would not be incrementally difficult to calculate.

Other factors in determining whether the de minimis threshold amount has been exceeded:

It is CMIC's strong view that the threshold levels should only take into account transactions to which either a derivatives dealer (whether a Canadian resident or otherwise) or a non-registered affiliate thereof is a party, on the one hand, and counterparties located in that specific province, on the other hand. Since derivatives dealer registration is done by province, the only relevant activity of a dealer would be activity within that province. Aggregated and anonymized data assembled by "sell" side members of CMIC shows that very few of their respective counterparties (i.e. under 40 in most cases, and in some cases, under 10 and in a couple of cases, currently the number is zero) are located in the smaller provinces and in the three territories (i.e. Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Northwest Territories, Nunavut, Prince Edward Island, Saskatchewan and Yukon Territory). This means that if a dealer needs to be registered in a province or territory where they have only a handful of clients in that jurisdiction, the cost and increased legal and regulatory risk of doing business in that jurisdiction will increase exponentially such that it will not make commercial sense to do business in that jurisdiction. This contraction of the OTC derivatives market in those jurisdictions only increases systemic risk and decreases liquidity in the market. CMIC therefore recommends that, for these smaller jurisdictions, an exemption should be available to a dealer (whether foreign or domestic) in respect of registration in that jurisdiction if the notional amount of transactions with counterparties located in that jurisdiction is below an appropriate *de minimis* threshold amount.

As noted, we are excluding from this calculation the trades of affiliates who are not registered as a dealer. If such affiliate is a registered dealer, its trades are already subject to regulatory supervision and therefore should be excluded from this calculation. Similarly, it is not clear why this exemption would not apply to a derivatives dealer that is already registered in a different jurisdiction of Canada, or registered under commodity futures legislation of any jurisdiction of Canada, or, in the case of a foreign dealer, if its head office or principal place of business is located in a jurisdiction that is listed in Column 1 of Appendix B. Therefore, these restrictions should not be included in the *de minimus* threshold exemption calculation.

(c) Passporting

As noted above, implementing a passporting regime will not resolve all the serious issues discussed in this letter, particularly the issue surrounding the independent right of a provincial regulator to initiate enforcement action against a registrant independent of other provincial securities regulators and independent of any prudential regulator (whether provincial or federal). Therefore, even though CMIC supports having a passporting regime in place, the comments below do not minimize the importance of its other recommendations, particularly those under the section headings "Exclusions" and "Extraterritorial Scope".

CMIC notes that the Proposed Rules do not explain how the registration process, exemptive relief process and the enforcement process would work among the CSA.[24] Given that the majority of OTC derivatives transactions are entered into with a foreign counterparty, CMIC recommends that the Companion Policy provide an explanation of these processes.

[24] Note that when we refer to "provincial" regulators or "provinces", we are also referring to the territorial regulators and the territories, respectively.

We understand that it is currently contemplated that a co-ordinated approach would be taken among the CSA which we understand to mean that a registered derivatives firm that enters into transactions, or advises, in all provinces will need to register in all provinces and pay fees to all of the provincial regulators. While the derivatives firm may be permitted to correspond with only its principal regulator for certain matters (but not all, such as the exception outlined in section 2(2) that is applicable to the foreign dealers and advisers exemption), such as providing notices, the derivatives firm would still be registered in all provinces and each provincial regulator would be entitled to separately bring enforcement action against the derivatives firm.

The co-ordinated approach is too cumbersome. CMIC is concerned that foreign derivatives firms will decide to cease doing business in a particular province in order to avoid registration in that province. The best approach would be to have a *de minimis* exemption in each province, as explained above. However, if the CSA does not accept this recommendation, CMIC strongly recommends that a passporting system be used such that there is only one regulator to deal with, and the payment of only one fee. We note that, to our knowledge, Canada will be the only jurisdiction which requires derivatives dealer and adviser registration in multiple jurisdictions in the same country. We are therefore very concerned that a multiple Canadian registration requirement will lead to serious reduction in liquidity and access, especially in the smaller provinces. This disruption of the Canadian OTC derivatives market will ultimately harm end-users who need to hedge commercial risks.

With respect to the definition of "principal regulator", CMIC notes that it only refers to the head office of a registered derivatives firm, and not to the principal place of business. It is not clear why that definition would not refer to the "head office or principal place of business". In fact, it would seem there would be a closer nexus to a jurisdiction if the principal place of business were located in that jurisdiction, as opposed to the head office (if they are not both in the same jurisdiction).

(d) Additional Registration Triggers

Section 6 of the Proposed Rules sets out additional registration triggers, one of which is if a person or company acts as a clearing intermediary on behalf of another person or company, other than an affiliated entity. In CMIC's view, clearing does not automatically render a party a dealer or market-maker and in our view, this should not be an additional registration trigger. As drafted, Section 6(c) of the Proposed Rules imposes additional requirements for clearing participants and intermediaries, which would have a materially negative effect on liquidity. These additional requirements will dis-incentivize firms from acting as clearing intermediaries to their clients, contrary to Canada's G20 commitments.[25] Clearing intermediaries are already sufficiently regulated under National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*. CMIC therefore recommends that Section 6(c) be deleted and if the intermediary is in fact a dealer or market-maker, such intermediary would be a "derivatives dealer" based on the definition of such term and the "business trigger" commentary in the Companion Policy.

[25] G20 Leaders Statement: The Pittsburgh Summit, September 24-25, 2009, Pittsburgh, at paragraph 13. Available here.

(e) Trade Reporting and Foreign Derivatives Dealers

CMIC is concerned about the interaction between the derivatives trade reporting rules in Ontario, Manitoba and Quebec (collectively, the "**TR Rules**") and the registration of foreign derivatives dealers. If a foreign derivatives dealer has to register under NI 93-102, it will become a "local counterparty" under the TR Rules and accordingly, all of its OTC derivatives transactions globally will be in scope for reporting under the TR Rules. It is not appropriate, and is unprecedented, for a local regulator to require a foreign dealer to submit derivatives data relating to transactions where neither party is organized in, nor has a head office or principal place of business in, that local jurisdiction. This is in contrast with the treatment of foreign derivatives dealers under the trade reporting rules for the rest of the Canadian jurisdictions. Under Multilateral Instrument 96-101 ("**MI 96-101**"), all derivatives dealers, whether registered or not, are considered "local counterparties" under that rule, however, pursuant to Section 42 of MI 96-101, derivatives data is not required to be reported if the only reason why it is being reported is that one or both of the parties to a transaction is a "local counterparty" because it is a derivatives dealer. CMIC is very concerned that if a similar exemption is not included in the TR Rules and foreign dealers are required to be registered under NI 93-102, this will be yet another reason for foreign dealers to exit, or not enter, the Canadian OTC derivatives market. CMIC does not believe that foreign dealers will find it acceptable that Canadian regulators will be able to access their derivatives data relating to trades with non-Canadian counterparties. Therefore, the TR Rules should be amended to include an exemption similar to the exemption under Section 42 of MI 96-101 in order for the trade reporting rules to be harmonized across Canada and to ensure that liquidity is not further reduced in the Canadian OTC derivatives market.

CMIC understands that the CSA views the CFTC rules in the U.S. as being equivalent to NI 93-102 and CMIC expects that these rules will be listed as one of the jurisdictions in Appendix B to NI 93-102. CMIC supports that result as it will avoid materially reducing liquidity in the Canadian OTC derivatives market. However, CMIC notes that the exemption under Section 52 of NI 93-102 applies only if the dealer is a foreign dealer, i.e. a dealer with its head office outside of Canada. If the CSA is providing an exemption under Section 52 to a U.S. dealer on the basis that it is a registered swap dealer under CFTC rules, such exemption should be available to all CFTC registered swap dealers, regardless of where its head office or principal place of business is located, whether in Canada or elsewhere. Otherwise, an uneven playing field is created, given that Canadian banks are required to be registered as swap dealers under CFTC rules (provided they exceed the *de minimis* threshold). Accordingly, to ensure that all dealers are treated equally, CMIC recommends that if an exemption is permitted under Section 52 on the basis of a swap dealer registration under CFTC rules, that exemption should be available to any CFTC registered swap dealer, regardless of where its head office or principal place of business is located.[26] If the CSA is unwilling to adopt this recommendation, the implementation of NI 93-102 should be delayed until such time as Canadian banks receive a similar exemption from US registration rules.

(f) Written Agreement for each Transaction:

Section 41 of the Proposed Rules provides that, in relation to each transaction, registered derivatives firm must enter into a written agreement[27] for the process of determining the value of each transaction. This provision, as currently drafted, is problematic from a market standard perspective. If Canadian rules are not harmonized on this point with global requirements, foreign dealers will not be willing to change their current procedures to accommodate the bespoke Canadian rules. Again, this will result in reduced liquidity in the Canadian OTC derivatives market.

[26] For FRFIs, this is an additional basis for granting an exclusion to FRFIs.

[27] We assume that this is in reference to the written agreement between two counterparties to a transaction, rather than an agreement between an adviser and the adviser's client. This section should therefore be revised to clarify that it does not apply to a registered derivatives adviser.

Currently, it is not market practice to execute an ISDA Master Agreement for most FX transactions. In fact, for shorter term FX transactions (generally, for terms up to two years), it is market practice to only execute electronic confirmations, such as SWIFT confirmations, where there is no ability to add additional language, such as a provision that the transaction is governed by an ISDA Master Agreement or the process for determining the value of each transaction. As it relates to FX transactions, the requirement under Section 41 of the Proposed Rules creates a significant compliance issue for all derivatives dealers currently transacting in FX transactions which will contribute to decreased liquidity in the Canadian derivatives market. Please see the second paragraph of Schedule C to this letter (Comparison to IOSCO Risk Mitigation Standards Report) which outlines why written agreements are not necessary for FX transactions.

CMIC notes that CFTC rules have a similar requirement, however, in order to satisfy this requirement for FX transactions, the ISDA March 2013 DF Protocol (the "**Protocol**") recognizes that it is not market standard to enter into an ISDA Master Agreement for FX transactions and therefore allows parties that adhere to the Protocol to agree to a "deemed" ISDA Master Agreement. CMIC members' experience was that the Protocol was not well-received. Significant difficulties were encountered in signing up clients in order to comply with US rules, even though the US is a much larger and more lucrative market. Due to the relative small size of the Canadian OTC derivatives market, liquidity will be significantly reduced if global market participants are required to adhere to a Canada-only protocol. Based on past experience by CMIC members, market participants will not respond or adhere to such a protocol and it is CMIC's strong belief that global market participants will simply find non-Canadian counterparties with whom to transact.

As it relates to non-FX transactions, entering into an ISDA Master Agreement, which sets out a close-out valuation procedure, should be sufficient in order to satisfy this requirement under Section 41. If the CSA requires an agreement that is different than the ISDA Master Agreement for non-FX transactions, this will be a significant departure from current market practice which will disrupt the Canadian OTC derivatives market. CMIC therefore recommends that the companion policy be amended to clarify that this requirement under Section 41 can be satisfied by entering into an ISDA Master Agreement (or incorporating the terms of an ISDA Master Agreement into a confirmation).

(g) Adviser Registration

CMIC is concerned that the registration of derivatives advisers is not something that has been adopted globally and accordingly it will be unlikely that foreign jurisdictions will have equivalent regimes which would qualify them to be listed in Appendix G or Appendix H of the Proposed Rules. [28] As noted earlier, given the relatively small size of the Canadian OTC derivatives market, it is CMIC's view that Canada should not be establishing bespoke regulation with respect to OTC derivatives. To CMIC's knowledge, there are no other registration regimes specifically for advisers of OTC derivatives. Accordingly, it is CMIC's view that the derivatives adviser regime should be removed from NI 93-102 until such time as the larger derivatives market globally have adopted such a regime. If the CSA is unwilling to accept our recommendation, CMIC recommends that CSA adopt a foreign derivatives adviser exemption that reflects the approach taken in the international advisor exemption in Section 8.26(4)(b) of NI 31-103 such that any foreign adviser registered or exempt from registration in its home jurisdiction would qualify for an exemption under NI 93-102. Similar to Section 8.26, this would not be dependent on the foreign adviser having a head office in a specific jurisdiction, or require compliance with any specified corresponding requirements or guidelines in the foreign

[28] In fact, CMIC understands that under Dodd-Frank, there is no formal registration requirement for "Associated Persons", which definition includes traders and salespersons, but swap dealers are required to maintain an internal list of names of these persons. This internal list is then subject to examination by U.S. regulators. There are currently no registration requirements for individuals, nor any specific examination or qualification requirements, however, there will be an National Futures Association examination requirement commencing January 2020.

jurisdiction. In addition, if the foreign adviser's home jurisdiction does not have legislation that specifically covers derivatives, then it should be sufficient for the foreign adviser to be registered or exempt from registration under its home jurisdiction's securities legislation. Taking this approach will allow market participants to continue to access expert advice from foreign advisers and will reduce the risk of foreign advisers withdrawing from the Canadian market.

In addition, CMIC is of the view that the Proposed Rules should include an exemption from derivatives dealer registration for registered derivatives advisers and their registered advising representatives that is similar to the adviser exemption for derivatives dealers and their representatives without discretionary authority in Section 58 of the Proposed Rules. If the derivatives dealing activity is in connection with a transaction for which the individual engaged in the dealing activity has the necessary proficiency under Section 18(1), then this should be sufficient, and the same rationale that applies to the inclusion of Section 58 in respect of derivatives advising activity should apply in the scenario of derivatives dealing activity.

The CSA should also consider the introduction of an exemption from derivatives dealer registration for derivatives advisers and their advising representatives, whether registered or not registered in the circumstances contemplated in CMIC's response to the CSA's Question #4 in Schedule D to this letter, that is similar to the adviser exemption for registered advisers and their advising representatives in Section 8.5.1 of NI 31-103, in that the exemption should be available where the dealing activities are "in connection with" the providing of advice to a client. While it is the case that the exemption in Section 8.5.1 is subject to the condition that the trade is made through a registered dealer or a dealer operating under an exemption from registration, it is CMIC's view that this condition is not appropriate for the derivatives market, since derivatives would not typically be transacted "through" a derivatives dealer.

Please also see CMIC's response to the CSA's Question #4 in Schedule D to this letter, in respect of advisers registered under Canadian securities legislation.

As you will have seen, CMIC has provided its comments and recommendations on the Proposed Rules by focussing on (i) necessary exclusions, (ii) extraterritorial scope comments and (iii) liquidity and access concerns. CMIC also re-iterates its very strong recommendation that a further, full comment period be afforded to market participants on both the registration rule and the business conduct rule (with all appendices filled in) so that they can both be analyzed together in order to determine their full effect on market participants and the Canadian OTC derivatives market.

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 Merrill Lynch
Bank of Montreal
Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Invesco Canada Ltd.

JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
Morgan Stanley
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Public Sector Pension Investment Board
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank

Schedule A to

CMIC RESPONSE LETTER TO PROPOSED NI 93-102

Comparison of NI 93-102 with Existing Canadian Bank Requirements

This analysis demonstrates that existing standards that apply to Canadian banks achieve a substantially equivalent outcome in respect of each specific proposed requirement under NI 93-102.[29] Moreover, the additional reference material below also demonstrates that OSFI's comprehensive, appropriate and robust framework for regulating over-the-counter derivatives, which has not been challenged as deficient, is also broadly consistent both with equivalent CFTC requirements and IOSCO recommendations, where applicable. Consequently, there are no benefits associated with requiring Canadian banks to register under 93-102, nor would there be any "gap" in regulation if Canadian banks were fully excluded in light of the significant risks associated with registration.

ANALYSIS			**REFERENCE**		
Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
1. Derivatives Ultimate Designated Person *Sections 16, 18, 27, 30*	Section 157(1) of the *Bank Act* imposes a duty on the board of a bank to manage or supervise the management of the bank and affairs of the bank. Under the *OSFI Supervisory Framework*, the board and senior management are designated as ultimately accountable for the safety and soundness of the bank. Guideline E-17 (*Background Checks on Directors and Senior Management of FREs*) sets out OSFI's expectations regarding the bank's procedures for assessing the	**Substantially equivalent outcome: diligent supervision** OSFI's supervisory standards achieve a substantially equivalent outcome as the CSA's proposed Ultimate Designated Person requirements.	Under CFR Title 17, s. 23.602, swap dealers must (i) establish and maintain a system to diligently supervise its activities, (ii) designate at least one person with authority to carry out supervisory responsibilities and (iii) reasonably ensure that supervisors are qualified and meet appropriate standards. The CFTC determined that the OSFI's supervision standards are generally identical in intent to CFTC requirements because they seek to ensure strict	DMI Report[31]: Recommendation 5: The market authority of the host jurisdiction in which the DMI is carrying on business should ensure that there are appropriate supervisory arrangements in place for the OTC derivatives business carried on by that DMI. Recommendation 10: DMIs should be required to have effective corporate governance frameworks designed to ensure appropriate management of OTC derivatives	Not required.

[29] Both the CSA and the CFTC have adopted this "outcomes-based" approach. In its notice of 93-102, the CSA indicate that they determine equivalence "where the requirement imposed by … the prudential authority achieves a substantially equivalent outcome as the Proposed Instrument." Similarly, in its substituted compliance decision with respect to entity level requirements for Canadian banks, the CFTC noted that it "ultimately focuses on regulatory outcomes (i.e., the home jurisdiction's requirements do not have to be identical". This approach recognizes that although "regulatory systems differ and their approaches vary … regulatory requirements nonetheless achieve the regulatory outcome sought to be achieved." https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-30979a.pdf at p. 78841.

[30] G20 commitments relating to OTC derivatives: http://www.fsb.org/wp-content/uploads/g20_leaders_declaration_pittsburgh_2009.pdf

[31] Technical Committee of the International Organization of Securities Commissions, *International Standards for Derivatives Market Intermediary Regulation – Final Report* (June 2012): https://www.iosco.org/library/pubdocs/pdf/IOSCOPD381.pdf ("**DMI Report"**) With respect to prudential regulators, the Report notes: "The standards in this Report do not purport to prescribe what type of governmental regulator or combination of governmental regulators should be responsible for the regulation and oversight of DMIs in a particular jurisdiction. For example, where a market authority does not have jurisdiction over prudential oversight of DMIs, the market authority **can rely on the prudential authority to address the recommendations relevant to prudential rules**" [emphasis added] (at pp. 4-5). We note that this Report also adopts an outcomes based approach: "The form the requirements take is less important than the outcome of them" (at p. 13).

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	suitability and integrity of directors and senior management. Individuals who play a significant role in the management of the bank, including senior management (a "**Responsible Person**"), may be found unsuitable for a particular position because of a lack of qualifications. OSFI expects that persons who do not possess the required suitability and integrity for a particular Responsible Person position will not be appointed to that position. If OSFI determines that a bank has taken insufficient action to resolve a situation OSFI deems to be of material risk, it has legislative authority to take remedial action under the *Bank Act*, sections 617.2, 647.1 and 964 (including on the grounds of lack of competence or experience). The *Corporate Governance* Guideline sets out OSFI's expectations regarding the effective oversight of banks' activities by their boards and senior management. Guideline E-13 (*Regulatory Compliance Management*), Section IV(viii) sets out the responsibility of senior management to ensure compliance measures are adequate and to supervise and promote compliance, including ensuring that all staff understand their responsibilities for complying with		compliance with applicable law, policies and procedures that would lead to compliance with applicable law, and an effective system of internal oversight and enforcement of such policies and procedures On that basis, the **CFTC determined that OSFI's supervision standards are comparable to and as comprehensive as the above CFTC requirements**. If the CSA provides US swap dealers with an exemption under s. 52, it follows that OSFI's standards must also achieve a substantially equivalent outcome as 93-102.	activities within the DMI. Recommendation 11: DMIs should be required to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their representatives. **These recommendations are already addressed in relation to Canadian banks.**	

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	policies, procedures and processes and are held to account for performance of their responsibilities.				
2. Derivatives Chief Compliance Officer *Sections 16, 18, 28, 30*	Under OSFI's *Corporate Governance* Guideline, the board of each bank is responsible for the selection, performance, management, compensation and evaluation of a Chief Compliance Officer (**CCO**). OSFI recognizes that the skills, competence, integrity and experience of a CCO are critical factors in the safety and soundness of the bank. OSFI Guideline E-13 (*Regulatory Compliance Management*) provides that: • The CCO should be assigned overall responsibility for assessment and management of regulatory compliance risk, including assessing the adequacy of, adherence to and effectiveness of the bank's day-to-day controls, and for providing an opinion to the board whether, based on the independent monitoring and testing conducted, the compliance controls are sufficiently robust to achieve compliance with the applicable regulatory requirements enterprise-wide. • The CCO must be independent from operational management and have sufficient stature, authority, resources and support within the bank to influence the bank's activities. • Staff assigned to compliance	**Substantially equivalent outcome: compliance oversight** OSFI's compliance oversight standards achieve a substantially equivalent outcome as the CSA's proposed Derivatives Chief Compliance Officer requirements.	Under CFR Title 17, s. 3.3, swap dealers must designate a chief compliance officer to perform various oversight functions, including developing and administering policies and procedures to ensure compliance. The chief compliance officer must provide an annual report to the board or senior officer prior to furnishing it to the CFTC. The CFTC determined that OSFI's CCO standards are generally identical in intent to CFTC requirements by seeking to ensure firms have designated a qualified individual as the compliance officer that reports directly to a sufficiently senior function of the firm and that has the independence, responsibility, and authority to develop and administer compliance policies and procedures reasonably designed to ensure compliance resolve conflicts of interest, remediate noncompliance issues, and report annually on compliance of the firm. On that basis, the **CFTC determined that CCO requirements of the OSFI**	DMI Report: Recommendation 13: DMI's management should be required to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and procedures. **This recommendation is already addressed in relation to Canadian banks.**	Not required.

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	responsibilities, including the CCO, should have the appropriate skills and knowledge of the business and regulatory environments that are essential to effective compliance. • The CCO should have a clearly defined and documented mandate, unfettered access, and for functional purposes, a direct reporting line to the board. • Normal course reports to the board should be made no less than annually, and contain discussion of material weaknesses, non-compliance issues, and remedial action plans. • The CCO should also provide an opinion to the board on a regular basis, but at least annually, on the adequacy of, adherence to and effectiveness of the day-to-day controls, and whether, based on the independent monitoring and testing conducted within the bank, the bank is in compliance with applicable regulatory requirements enterprise-wide. • OSFI expects the CCO to report to the board, on a timely basis, material instances of non-compliance, compliance issues and any measures to remediate issues or implement new or revised controls. The bank's management of regulatory compliance risk is monitored by OSFI in accordance with the *OSFI Supervisory Framework* and reported on annually to the		**standards are comparable to and as comprehensive as the above CFTC requirements**.[32] If the CSA provides US swap dealers with an exemption under s. 52, it follows that OSFI's standards must also achieve a substantially equivalent outcome as 93-102.		

[32] With the exception of the requirement to furnish an annual report to the CFTC. However, because 93-102 does not provide for an analogous requirement to furnish an annual report to each securities commission, this exception is not relevant in the context of 93-102.

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	Minister of Finance.				
3. Derivatives Chief Risk Officer *Sections 16, 18, 29, 30*	*Risk Appetite Framework* The *Corporate Governance* Guideline requires that each bank establish a risk appetite framework ("**RAF**") that: • guides risk-taking activities; • sets basic goals, benchmarks, parameters, and limits, and should consider material risks; and • contains certain required elements, including a risk appetite statement, risk limits, and an outline of roles and responsibilities for implementation of the RAF. The *Corporate Governance* Guideline requires that senior management (including the CRO) oversee regular reviews of risk management systems and practices to ensure that they remain appropriate and effective in light of changing circumstances and risks. The board should seek assurances from senior management (including the CRO) that risk management controls are operating effectively, and that risk positions are in compliance with the delegated authorities and limits. The board should also establish processes to periodically verify the assurances provided to it. *Risk Committee* The *Corporate Governance* Guideline directs DSIBs to establish a dedicated risk committee to oversee risk management on	**Substantially equivalent outcome: robust risk management** OSFI's risk management standards achieve a substantially equivalent outcome as the CSA's proposed Derivatives Chief Risk Officer requirements.	Under CFR Title 17, s. 23.600, swap dealer obligations include: (i) establish and enforce a risk management program through policies and procedures designed to monitor and manage risks, (ii) establish an independent risk management unit; (iii) provide for quarterly review by senior management and annual review by the governing body of risk tolerance limits and exceptions; (iv) provide senior management and the governing body with quarterly risk exposure reports and on detection of a material change in risk exposure; (v) furnish risk exposure reports to the CFTC; and (vi) review and test the risk management program annually and on any material change in business. The CFTC determined that OSFI's risk management standards are generally identical in intent to CFTC requirements by requiring a system of risk management that seeks to ensure that firms are adequately managing the risks of their swaps activities. On that basis, the **CFTC determined that risk management requirements of the OSFI standards are comparable to and**	DMI Report: Recommendation 12: DMIs should be required to maintain risk management systems and organization to properly identify and manage their OTC derivatives related business risks. **This recommendation is already addressed in relation to Canadian banks.**	Not required.

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	an enterprise-wide basis. The Risk Committee: • should have a sound understanding of the types of risks to which the bank may be exposed and of the techniques and systems used to identify, measure, monitor report and mitigate those risks; • should have a clear mandate and sufficient knowledge in the risk management of financial institutions (including individuals with technical knowledge in risk disciplines, where appropriate); • should seek assurances from the CRO that risk management activities of the bank are independent from operational management, are adequately resourced, and have appropriate status and visibility; • should receive timely and accurate reports on significant risks of the bank and exposures relative to the bank's risk appetite; • should provide input to the approval of material changes to the bank's strategy and corresponding risk appetite; and • should be satisfied with the manner in which material exceptions to policies and controls are identified, monitored, measured and controlled, as well as the remedial actions when exceptions/breaches are identified. *Chief Risk Officer* The *Corporate Governance* Guideline recommends that each bank have a		**as comprehensive as the above CFTC requirements**.[33] If the CSA provides US swap dealers with an exemption under s. 52, it follows that OSFI's standards must also achieve a substantially equivalent outcome as 93-102.		

[33] With the exception of the requirement to produce a quarterly risk exposure report and provide such report to senior management, the governing body, and the CFTC. However, because 93-102 does not provide for an analogous requirement in respect of a quarterly report, this exception is not relevant in the context of 93-102.

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	designated Chief Risk Officer (**CRO**), with sufficient stature and authority within the organization, and who is also independent from operational management. The Guideline also provides as follows: • The board is responsible for the selection, performance, management, compensation and evaluation of the CRO. OSFI recognizes that the skills, competence, integrity and experience of a CRO are critical factors in the safety and soundness of the bank. • The CRO should have unfettered access to the board or Risk Committee and (for functional purposes) a direct reporting line to the board or Risk Committee. • The CRO is the head of the bank's risk management function, responsible for identifying, measuirng, monitoring and reporting on risks of a bank, independent of business lines or operational management. • The CRO should not be involved in revenue-generation orin management and financial performance, nor should the CRO's compensation be linked to the performance of specific business lines. • The CRO's on-going assessment of risk-taking activities should remain objective • The CRO should provide regular reports to the board, the risk committee, and senior management, should provide an objective view, and should meet with the risk committee or				

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	the board on a regular basis. • The CRO and risk management function should have processes and controls in place to assess the accuracy of risk information or analysis to be in a position to offer objective reporting *Derivatives* Guideline B-7 (*Derivatives Sound Practices*) provides that the process of risk management for derivatives is integrated into a bank's overall risk management program. Banks should be in a position to identify the material risks they face with respect to derivatives activities, assess their potential impact and have policies and controls in place to manage risk effectively. A bank's derivatives activities should, consistent with the RAF, be subject to risk limits approved by the board. Effective control, monitoring and reporting systems and procedures should be in place to ensure on-going operational compliance with the RAF.				
4. Proficiency *Section 18* *Note: Proficiency in respect of*	Guideline B-7 (*Derivatives Sound Practices*) provides that staff who are involved in trading or providing advice in relation to derivatives trades should have the appropriate education, skills, experience and	**Substantially equivalent outcome: proficient staff** OSFI's proficiency standards achieve a substantially equivalent outcome as the CSA's proposed	No equivalent. Under CFR Title 17, only the CCO and supervisors are subject to a general proficiency requirement, and no individuals are subject to specific proficiency requirements.	DMI Report: Recommendation 13: DMI's management should be required to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable	Not required.

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supervisory, compliance and risk management functions are also addressed above under items 1-3.	training to carry out their responsibilities. Guideline E-13 (*Regulatory Compliance Management*), Section IV(viii) sets out the responsibility of senior management to ensure that all staff understand their responsibilities for complying with policies, procedures and processes and are held to account for performance of their responsibilities. The *Corporate Governance* Guideline reflects OSFI's expectation for banks to have knowledgeable and competent individuals with a clear understanding of their role and a strong commitment to carrying out their respective responsibilities.	proficiency requirements.		assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and procedures. **This recommendation is already addressed in relation to Canadian banks.**	
5. Registration of individuals *Section 16*	*Holding Staff to Account* OSFI's *Supervisory Framework* provides that a bank's board and senior management are responsible for the management of the bank and ultimately accountable for its safety and soundness and compliance with governing legislation. Guideline E-13 (*Regulatory Compliance Management*), Section IV(viii) sets out the responsibility of senior management to ensure that all staff understand their	**Substantially equivalent outcomes: holding individuals to account and disclosure of relevant information** OSFI's standards relating to individual accountability for performance, together with its ability to penalize individuals for failure to comply with OSFI requirements, achieves a substantially equivalent outcome as the CSA's proposed requirements relating to individual registration in relation to individual	No equivalent. Supervisors, CCOs, CROs and "associated persons" are not required to register with the CFTC.	DMI Report: Recommendation 4: Relevant material information on licensed or registered DMIs should be made publically available. This information may include the names of senior management and those acting on its behalf. **This recommendation is already addressed in relation to Canadian banks.**	Not required.

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	responsibilities for complying with policies, procedures and processes and are held to account for performance of their responsibilities. There are broad provisions for individual penalties under the *Bank Act*. In particular, Section 980 provides that every person who, without reasonable cause, contravenes any provision of this Act or the regulations is guilty of an offence. Section 980.1 further provides that every person who knowingly provides false or misleading information in relation to any matter under the Act or the regulations is guilty of an offence. Failing to provide information and/or making false statements can also constitute an offence under Sections 982 and 984, respectively. Section 986 extends the liability for an offence to any officer or director of the Bank who "directed, authorized, assented to, acquiesced in or participated in the commission of the offence…" Penalties for individuals include fines and/or imprisonment. Section 25(2) of the *Office of the Superintendent of Financial Institutions Act* ("**OSFI Act**") provides that OSFI may impose a maximum penalty on a natural person of $10,000 for a minor violation,	accountability. In addition, banks are also already subject to disclosure of relevant information through counterparty onboarding requirements and existing public issuer disclosure requirements. By providing counterparties with necessary information regarding banks and senior management, these requirements achieve a substantially equivalent outcome as the CSA's proposed requirements relating to individual registration.			

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	$50,000 for a serious violation and $100,000 for a very serious violation. The *Administrative Monetary Penalties (OSFI) Regulations* (the "**AMP Regulations**") provide that penalties can be imposed in connection with non-compliance with (i) an order made by OSFI under the *Bank Act*, (ii) a direction made under the *Bank Act* to cease or refrain from committing an act or pursuing a course of conduct that is an unsafe or unsound practice, or to perform a remedial act, (iii) terms and conditions imposed by OSFI or an undertaking given to OSFI under the *Bank Act*, or (iv) a prudential agreement entered into with OSFI under the *Bank Act*. *Disclosure to Counterparties* Banks routinely provide KYC, AML, Canadian Representation Letters, LEIs, authorized signing authority and other onboarding documentation to our counterparties. In this regard, Guideline B-7 *(Derivatives Sound Practices)* requires banks to "act honestly and in good faith when marketing, negotiating, entering into, executing and administering transactions with its clients or counterparties."				

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	Reporting Issuer Disclosures Canadian banks are reporting issuers and provide disclosures as required under NI 51-102, including the names of each director and officer as required by Item 10 on Form 51-102F2 *Annual Information Form*.				
6. Capital Requirements *Section 31*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	No equivalent.	DMI Report: Recommendation 6: Market authorities should consider imposing some form of capital or other financial resources requirements for DMIs that are not prudentially regulated that reflect the risks that these intermediaries undertake. **This recommendation is already addressed in relation to Canadian banks.**	Not required.
7. Direction to conduct audit *Section 32*	Section 308 of the *Bank Act* requires banks to conduct an annual audit on a consolidated basis.	**Substantially equivalent outcome: audit** The *Bank Act* audit requirement achieves a substantially equivalent outcome as the CSA's proposed audit requirement.	No equivalent.	No relevant recommendation.	Not required.
8. Co-operating with the auditor	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially**	No equivalent.	No relevant recommendation.	Not required.

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Section 33		**equivalent outcome**.			
9. Financial statements *Sections 34-36*	*Bank Act* Sections 308 and 840 of the *Bank Act* require banks to prepare audited annual financial statements with certain prescribed disclosures set out in Guideline D1 (*Annual Disclosures*) and D6 (*Derivatives Disclosure*) and according to IFRS 9 (*Financial Instruments and Disclosures*). *Reporting Issuer Disclosures* As reporting issuers, banks are required to publicly file annual and quarterly financial statements. Part 4 of NI 51-102 sets out the filing requirements.	**Substantially equivalent outcome: financial disclosure** The *Bank Act* and reporting issuer obligations achieve a substantially equivalent outcome as the CSA's proposed financial statement requirements.	No equivalent.	No relevant recommendation.	Not required.
10. Delivering financial information *Section 37*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	No equivalent.	No relevant recommendation.	Not required.
11. Compliance policies and procedures *Section 38*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.402(a) requires swap dealers to have written policies and procedures reasonably designed to ensure compliance.	DMI Report: Recommendation 11: DMIs should be required to design supervisory policies and procedures to manage their OTC derivatives operations and the activities of their	Not required.

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Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
				representatives. Recommendation 13: DMI's management should be required to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and procedures. **These recommendations are already addressed in relation to Canadian banks.**	
12. Risk management policies and procedures *Section 39*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.600(b) requires swap dealers to establish risk management policies and procedures designed to monitor and manage the risks associated with the swaps activities of the swap dealer.	DMI Report: Recommendation 12: DMIs should be required to maintain risk management systems and organization to properly identify and manage their OTC derivatives related business risks. Recommendation 13: DMI's management should be required to establish, maintain and apply policies, procedures and systems of control sufficient to provide reasonable assurance that the DMI and each individual acting on its behalf are competent and comply with applicable regulatory standards and the DMI's internal policies and	Not required.

ANALYSIS			REFERENCE		
Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
				procedures. **These recommendations are already addressed in relation to Canadian banks.**	
13. Confirmation of material terms *Section 40*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17, Section 23.501 requires a swap dealer to execute a written transaction confirmation when trading with a swap dealer, major swap participant or financial institution, or to deliver a written acknowledgement of a transaction when trading with another counterparty, and subsequently execute a written transaction confirmation	Risk Mitigation Standards[34]: Standard 3: Covered entities should establish and implement policies and procedures to ensure the material terms of all non-centrally cleared OTC derivatives transactions are confirmed as soon as practicable after execution of the transaction. **This standard is already addressed in relation to Canadian banks.**	Not required.
14. Agreement for process of determining value of a derivative *Section 41*	Guideline B-7 (*Derivative Sound Practices*) provides that a bank should satisfy itself that the terms of any contract governing its derivatives activities are legally sound and the underlying transaction documentation is adequate. OSFI notes this is especially important with respect to provisions governing the calculation of settlement	**Substantially equivalent outcome: agreement of material terms to promote legal certainty** OSFI's standards regarding derivatives agreements achieve a substantially equivalent outcome as the CSA's proposed agreement	CFR Title 17 Section 23.504(b)(1) requires swap trading relationship documentation to be in writing and to include all terms governing the trading relationship between the swap dealer and its counterparty, including valuation.	Risk Mitigation Standards: Standard 2: Covered entities should establish and implement policies and procedures to execute written trading relationship documentation with their counterparties prior to or contemporaneously with executing a non-centrally cleared OTC	Not required.

[34] The Board of the International Organization of Securities Commissions, *Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives* (January 2015) https://www.iosco.org/library/pubdocs/pdf/IOSCOPD469.pdf ("**Risk Mitigation Standards**"). "Covered entities" in this Report refers to financial entities and systemically important non-financial entities which at a minimum would be applied consistent with application of the margin requirements for non-centrally cleared OTC derivatives (s. 1.2). The Report also notes that "[O]nly non-centrally cleared OTC derivatives transactions **between two covered entities** are subject to the standards in this report [emphasis added]" (s. 1.3; also see 1.6).

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	amounts payable to or between parties upon the termination of a transaction. In order to promote legal certainty, banks should seek to agree in writing with counterparties to all material terms governing their trading relationship prior to or at the time of execution of a non-centrally cleared derivative. Guideline B-7 also provides that in order to reduce counterparty credit risk exposure, a bank should, where practicable, use legally enforceable bi-lateral and multi-lateral netting agreements with its counterparties. Further, OSFI expect that banks using derivatives instruments where material valuation uncertainty exists (e.g., instruments with complex payoffs, thinly traded or less liquid instruments where there are no readily available market prices) should have valuation and risk management processes that explicitly assess valuation uncertainty commensurate with the size and depth of its activities. Such assessments should be included in communication to senior management and/or the board, in their respective roles. OSFI Guideline E-22 (*Margin Requirements for Non-Centrally Cleared Derivatives*)	requirement.		derivatives transaction. Such documentation should include all material terms governing the trading relationship between the counterparties. However, in the case of one-off transactions, trading relationship documentation could take the form of a trade confirmation that includes all material rights and obligations of the counterparties to the non-centrally cleared OTC derivatives transactions, which have been agreed between them. Standard 4: Covered entities should agree on and clearly document the process for determining the value of each non-centrally cleared OTC derivatives transaction at any time from the execution of the transaction to the termination, maturity, or expiration thereof, for the purpose of exchanging margins. **These standards are already addressed in relation to Canadian banks.**	

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	requires mark-to-market (or for complex or illiquid trades, mark-to-model) exposure calculation connection with the exchange of variation margin.				
15. Agreement for process relating to disputes Policies and procedures for dispute resolution *Section 42(1) and (2)*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.504(b)(1) requires swap trading relationship documentation to include dispute resolution terms.	Risk Mitigation Standards: Standard 7: Covered entities should agree on the mechanism or process for determining when discrepancies in material terms or valuations should be considered disputes, as well as how such disputes should be resolved as soon as practicable. The mechanism or process should provide for the escalation of material disputes to an appropriate level of senior management at the entity. Authorities may consider specifying in regulatory requirements or guidance whether covered entities should report to the relevant authority a valuation dispute in excess of an amount determined by regulation or above a pre-agreed threshold that is not resolved within a reasonable period of time. **This standard is already addressed in relation to Canadian banks.**	Not required.
16. Reporting unresolved disputes	OSFI Guideline B-7 (*Derivatives Sound Practices)* requires banks to implement procedures to resolve any discrepancies or	**Substantially equivalent outcomes: ensuring resolution of disputes and escalation of material issues**	No equivalent.	Risk Mitigation Standards: Standard 7: Covered entities should agree on	Not required.

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Section 42(3) and (4)	disputes with respect to material terms and valuations in a timely manner. OSFI Guideline E-22 (*Margin Requirements for Non-Centrally Cleared Derivatives*) requires that in the event that a margin dispute arises, covered entities should make all necessary and appropriate efforts, including timely initiation of dispute resolution protocols, to resolve the dispute. Pursuant to Section 455 of the *Bank Act*, a bank must (a) establish procedures for dealing with complaints made by persons having requested or received products or services in Canada from a bank, (b) designate an officer or employee of the bank to be responsible for implementing those procedures; and (c) designate one or more officers or employees of the bank to receive and deal with those complaints. In addition, pursuant to the *Complaints (Banks, Authorized Foreign Banks and External Complaint Bodies) Regulations*, banks must report to the public the number of complaints received, the average length of time to deal with complaints and the number of complaints resolved satisfactorily. In addition, the Financial Consumer Agency of Canada (which has jurisdiction over banks) has issued Guidance CG-12 *Internal dispute*	OSFI's standards regarding dispute resolution achieve a substantially equivalent outcome as the CSA's proposed requirement.		the mechanism or process for determining when discrepancies in material terms or valuations should be considered disputes, as well as how such disputes should be resolved as soon as practicable. The mechanism or process should provide for the escalation of material disputes to an appropriate level of senior management at the entity. Authorities may consider specifying in regulatory requirements or guidance whether covered entities should report to the relevant authority a valuation dispute in excess of an amount determined by regulation or above a pre-agreed threshold that is not resolved within a reasonable period of time. **This standard is already addressed in relation to Canadian banks.**	

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	resolution which provides further guidance on the requirements in respect of such policies and procedures. OSFI Guideline E-13 (*Regulatory Compliance Management*) sets out OSFI's expectation for the CCO to report to the board, on a timely basis, material instances of non-compliance, compliance issues and any measures to remediate issues or implement new or revised controls. In addition, regular reports to senior management and the board allow them to clearly understand the regulatory risks to which the bank is exposed, and the adequacy of key controls to manage those risks. OSFI's *Supervisory Framework* provides that OSFI reports annually to the Minister of Finance on the safety and soundness of banks and their compliance with the governing legislation.				
17. Business continuity and disaster recovery *Section 43*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.603(a) requires swap dealers to establish a written business continuity and disaster recovery plan. The CFTC determined that OSFI standards are generally identical in intent to CFTC	DMI Report: Recommendation 14: DMIs should be required to develop and maintain an effective business continuity plan, based on their size, risks, and the nature of their operations, to allow them to mitigate, respond to and recover from business	Not required.

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Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
			requirements because such standards seek to ensure that any market disruption affecting swap dealers is minimized and seek to ensure that entities adequately plan for disruptions and devote sufficient resources capable of carrying out an appropriate plan in a timely manner. On that basis, the **CFTC determined that business continuity and disaster recovery requirements of the OSFI standards are comparable to and as comprehensive as the above CFTC requirements.**	disruptions or disasters. **This recommendation is already addressed in relation to Canadian banks.**	
18. Portfolio reconciliation *Section 44*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.502 requires swap dealers to engage in portfolio reconciliation as provided therein.	Risk Mitigation Standards: Standard 5: Covered entities should establish and implement policies and procedures to ensure that the material terms and valuations of all transactions in a non-centrally cleared OTC derivatives portfolio are reconciled with counterparties at regular intervals. **This standard is already addressed in relation to Canadian banks.**	Not required.
19. Portfolio compression *Section 45*	Analysis not necessary	In Appendix F to 93-102, the **CSA has recognized that OSFI's standards achieve a substantially equivalent outcome**.	CFR Title 17 Section 23.503 requires swap dealers to engage in portfolio compression as provided therein.	Risk Mitigation Standards: Standard 6: Covered entities should establish and implement policies and procedures to regularly assess and, to the extent	Not required.

ANALYSIS			REFERENCE		
Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
				appropriate, engage in portfolio compression. **This standard is already addressed in relation to Canadian banks.**	
20. Records requirements *Sections 46-47*	Sections 238, 239 and 597 of the *Bank Act* generally require banks carrying on business in Canada to maintain records in Canada and to ensure that OSFI can access in Canada any records necessary to enable OSFI to fulfill its supervisory mandate. In particular, pursuant to Section 238 of the *Bank Act*, a bank must prepare and maintain records containing the following (a) the incorporating instrument and the by -laws of the bank, (b) minutes of meetings and resolutions of shareholders and members, (c) the names of directors and auditors, (d) particulars of any authorizations, conditions and limitations established by OSFI in respect of the commencement and carrying on of business of the bank that are from time to time applicable to the bank, (e) particulars of exceptions granted in respect of any discontinuance, permission to a subsidiary of a foreign bank, or a sale of all or substantially all of its assets that are from time to time applicable to the bank; and (f) particulars from Schedule I or II that are applicable to the bank as they are from time	**Substantially equivalent outcome: comprehensive recordkeeping relating to derivatives.** OSFI's recordkeeping standards achieve a substantially equivalent outcome as the CSA's proposed recordkeeping requirement.	CFR Title 17 Section 23.201-203 requires swap dealers to keep full, complete, and systematic records (a) of all its swaps activities, including transaction records, position records and (b) of all activities related to its business as a swap dealer including governance, financial, complaints and marketing and sales materials. These sections also set out time periods required for records retention. The CFTC determined that OSFI's recordkeeping standards (i) are generally identical in intent to CFTC requirements because these standards seek to ensure the effectiveness of internal controls and transparency for regulators and market participants, (ii) require banks to keep data in a sufficient level of detail and (iii) employ effective risk management and facilitate strict compliance and regulatory oversight by requiring comprehensive records. On that basis, **the CFTC determined that**	DMI Report: Recommendation 15: DMIs should be required to retain OTC derivatives transaction records and be able to provide them in a timely, organized and readable manner. The record retention period for OTC derivatives transactions should apply for a specified period after its termination, maturity or assignment. **This recommendation is already addressed in relation to Canadian banks.**	Not required.

ANALYSIS			REFERENCE		
Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20[30]**
	to time amended and published in the Canada Gazette. In addition, a bank must prepare and maintain adequate (a) corporate accounting records, (b) records containing minutes of meetings and resolutions of the directors and any committee thereof; and (c) records showing, for each customer of the bank, on a daily basis, particulars of the transactions between the bank and that customer and the balance owing to or by the bank in respect of that customer. Section 368 requires records to be retained for six years following dissolution. In addition, OSFI's Supervisory Framework requires banks to establish and maintain an enterprise-wide RCM framework of regulatory risk management controls, and these controls include oversight functions that are independent of the activities they oversee. OSFI expects the RCM framework to include ''Adequate Documentation'' as one of its key controls. Guideline B-7 (*Derivatives Sound Practices*) provides that banks should have mechanisms in place to assure the		**OSFI recordkeeping requirements are comparable to and as comprehensive as the above CFTC requirements.**[35] If the CSA provides US swap dealers with an exemption under s. 52, it follows that OSFI's standards must also achieve a substantially equivalent outcome as 93-102.		

[35] With the exception of the requirement to make records open to inspection by U.S. regulators. However, because 93-102 does not provide for an analogous requirement, this exception is not relevant in the context of 93-102.

ANALYSIS			REFERENCE		
Proposed NI 93-102: Derivatives Registration	**Existing Requirements for Canadian Banks**	**Conclusion**	**CFTC**	**IOSCO**	**G20**[30]
	confirmation, maintenance, and safeguarding of derivatives contract documentation. Guideline B-7 also sets out OSFI's expectation that banks report derivatives transactions following the derivatives data reporting requirements that have been adopted in the province in which the head office and/or principal place of business of the bank is located. Section 36 of 91-507 (Ontario, Manitoba and Quebec) and MI 96-101 (rest of Canada) requires reporting parties to keep transaction records for the life of the transaction and for a further 7 years following expiration or termination.				

SCHEDULE B TO
CMIC RESPONSE LETTER TO PROPOSED NI 93-102

Comparison to IOSCO DMI Report

NI 93-102	IOSCO
Derivatives Ultimate Designated Person (from NI 31-103)	Does not recommend specific positon – appropriate supervisory arrangements and management
Derivatives-specific CCO	Does not recommend specific position – sufficient control systems
Derivatives-specific CRO	Does not recommend specific position – risk management systems and organization
Specific proficiency requirements	Does not recommend specific requirements – “reasonable assurance” of competence
Registration of individuals	Does not recommend registration – relevant material information on DMIs should be publicly available and <u>may</u> include names of senior management and those acting on its behalf
Capital requirements – applicable to all registrants	Only applicable to DMIs that are not prudentially regulated
Audit, auditor, financial statements and financial information	No recommendations
Confirmation of material terms, agreement for determining value of derivative, disputes, portfolio reconciliation – applicable to all counterparties Portfolio compression – applicable to non-centrally cleared derivatives firms (whether registered or not)	Recommendations apply only to “covered entities” (similar coverage to margin rules) for non-centrally cleared derivatives
Agreement of material terms – no exemption for “one-off” transactions which is how trading occurs and in the FX market if no ISDA	For “one-off” transaction, trading documentation could take the form of a confirmation. Also recognizes that each product has different risks and jurisdictions should consider whether there is a regulatory need for creating specific registration requirements for each type of derivative product.
Dispute management – escalation of all unresolved disputes to board	Escalation of material unresolved disputes to senior management
Dispute management – escalation of all unresolved disputes to regulator	Authorities <u>may</u> consider specifying escalation to regulator above a pre-agreed threshold
Records – include financial statements and excess working capital, transaction records, minutes of board meetings, records of organizational structure, audit, compliance and risk management reports, business and strategic plans and financial records	Limited to transaction records

SCHEDULE C TO

CMIC RESPONSE LETTER TO PROPOSED NI 93-102

Comparison to IOSCO Risk Mitigation Standards Report

<u>Confirmation of Material Terms, Agreement for Determining Value, Dispute Resolution, Portfolio Reconciliation and Portfolio Compression</u>

IOSCO Risk Mitigation Standards Report: It is CMIC's understanding that Sections 40-45 are in the Proposed Rules, as opposed to the Business Conduct Rule, because each of these sections cover items that include a risk management component, as opposed to dealing with business conduct and "bad" behaviour. CMIC further understands that these provisions are based on recommendations from IOSCO under its Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives (the "**IOSCO Report**").[36] Based on a review of the IOSCO Report, CMIC notes the following:

- Section 1.3 of the IOSCO Report explicitly notes that the standards in the report only apply to non-centrally OTC cleared derivatives. In CMIC's view, this point illustrates that it is not global practice to apply these standards to centrally cleared derivatives. Also, section 1.6 of the report indicates that the standards apply only as between "covered entities" which are defined as "financial entities and systemically important non-financial entities". Section 1.2 of the report provides that the scope of "covered entities" should, at a minimum, be equivalent to covered entities that are subject to margin requirements for non-centrally cleared OTC derivatives. In CMIC's view, this means that it is not market practice, or practicable, and not consistent with global regulatory standards to apply these standards to all counterparties. Accordingly, Sections 40-45 of the Proposed Rules should not apply to centrally cleared OTC derivatives, including the alpha trade. Further, it is CMIC's view that the application of these provisions should be delayed until the CSA finalizes its margin rule. Otherwise, the CSA would risk applying these provisions beyond the scope anticipated by IOSCO. If the CSA is unwilling to delay the application of these provisions, it is CMIC's view that these provisions be limited only to derivatives parties with which the derivatives firm is already required to exchange variation margin under applicable margin rules/regulations.

- CMIC notes that in Section 2.3 of the IOSCO Report, IOSCO appears to recognize that the trading relationship documentation for FX transactions could occur through a confirmation rather than through a written agreement prior to or at the time of execution: "In the case of one-off transactions, trading relationship documentation could take the form of a trade confirmation that includes all material rights and obligations of the counterparties to the non-centrally cleared OTC derivatives transactions which have been agreed between them."[37] FX transactions that are not executed under an ISDA are "one-off" transactions as indicated in the IOSCO Report and that in those instances, a trade confirmation, including a SWIFT confirmation, is sufficient to satisfy the requirements under Section 41 of the Proposed Rules.

- With respect to dispute resolution, Section 7.1 of the IOSCO Report indicates that "the mechanism or process should provide for the escalation of material disputes to an appropriate level of senior management at the entity". CMIC accordingly recommends that Section 42(3) of the Proposed Rules be amended to allow for escalation to a firm's senior management and not directly to the board of directors. Further, CMIC notes that Section 42(3) does not include

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[36] Risk Mitigation Standards for Non-centrally Cleared OTC Derivatives, Report of the Board of IOSCO, January 28, 2015. Available here.

[37] *Ibid*, pg. 7.

a materiality concept. Only disputes which are material to the derivatives firm should be escalated to senior management.

- In addition, Section 7.2 of the IOSCO Report provides that authorities may consider specifying in regulatory requirements or guidance whether covered entities should report to the relevant authority a valuation dispute in excess of an amount determined by regulation or above a pre-agreed threshold that is not resolved within a reasonable period of time. Accordingly, it is entirely appropriate for the Proposed Rules to allow parties to the derivatives transaction to have the ability to agree to a threshold such that only disputes above such threshold are reported to the regulators.

SCHEDULE D TO
CMIC RESPONSE LETTER TO PROPOSED NI 93-102

RESPONSES TO QUESTIONS

1) Methodology for determining "notional amount"

Q: Annex I describes two different methodologies for determining notional amount for derivatives that reference a notional quantity (or volume) of an underlying asset: (i) the methodology based on the CDE Guidance, set out in Column 1 of Annex I, and (ii) the Regulatory Notional Amount methodology set out in Column 2 of Annex I.

(a) Please provide any comments relating to the constituent elements (price, quantity, etc.) of the proposed methodologies.

(b) Please provide comments on the most appropriate approach to determining the notional amount, for the purpose of regulatory thresholds, of a derivative with a notional amount schedule, including a schedule with notional amounts not denominated in Canadian dollars.

(c) Please provide comments on the most appropriate approach to determining notional amount for a multi-leg derivative.

For example, in a multi-leg derivative with multiple legs that are exercisable, deliverable or otherwise actionable and that are not mutually exclusive, is it appropriate to determine the notional amount for the derivative by summing the notional amount for each such leg that is exercisable, deliverable or otherwise actionable and that is not mutually exclusive?

Other multi-leg derivatives may have multiple legs that are not exercisable, deliverable or otherwise actionable or that are mutually exclusive. For these types of multi-leg derivatives, is it appropriate to determine the notional amount for the derivative by using a weighted average of the notional amount of each such leg that is not exercisable, deliverable or otherwise actionable or that is mutually exclusive?

(d) Please provide any general comments on determining notional amount for the purpose of regulatory thresholds, including relating to implementation of the proposed methodologies.

Answer:

With respect to all of the above questions, it is CMIC's view that whatever approach is taken, it should be harmonized with the approach taken globally. To that end, CMIC directs the CSA to the article by ISDA[38] which identifies the predominant use of notional amount outstanding by regulators in major jurisdictions globally, which will inform the discussion about whether the use of notional amount thresholds is appropriate for regulations that are intended to address risk. A risk-based approach certainly seems like a reasonable approach in circumstances where regulations are intended to address risk, however, as we have noted before, Canada should not be introducing bespoke OTC derivatives legislation, given the relative small size of the Canadian market. It would be reasonable for the CSA to align with whatever approach the CFTC has taken with respect to notional amounts, or will take in the future, particularly as they have had experience calculating notional amounts in the context of its *de minimis* threshold exemption from swap dealer registration.

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[38] Uses of Notional Amount in Derivatives Regulation, ISDA. May 2018. Available here.

2) Definition of "affiliated entity"

Q: 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 II). Please provide any comments you may have on (i) the definition in the Instrument, (ii) a definition in Annex II, and (iii) the appropriate balance between harmonization across related rules and using different definitions to more precisely target specific entities under different rules.

Answer:

Whichever approach is adopted, the definition of “affiliated entity” should be the same for all OTC derivatives rules in all provinces. This will reduce confusion, in particular, to foreign market participants, and will avoid participants selecting a particular jurisdiction solely due to the differences in treatment of affiliated entities. Given this broad application of this definition, it is CMIC’s view that a separate consultation should be conducted by the CSA with regard to which approach to be adopted.

3) Definition of "eligible derivatives party"

Q: 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.

Answer:

We refer you to page 13 of this letter as well as our discussion in our Business Conduct Response relating to the following recommended changes to the definition of “eligible derivatives party”:

- remove the financial threshold for commercial hedgers in paragraph (n);
- lower the financial threshold in paragraph (m) for a non-individual from net assets of $25 million to total assets of $10 million; and
- remove the knowledge and experience requirement under paragraphs (m), (n) and (o).

4) Application of the derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation

Q: Under the Proposed Instrument, a person or company engaging in or holding himself, herself or itself out as engaging in the business of advising others in derivatives will be required to register as a derivatives adviser unless an exemption from registration is available.

We understand that a registered adviser under securities or commodity futures legislation may provide advice in relation to derivatives or strategies involving derivatives, or may manage an account for a client and make trading decisions for the client in relation to derivatives or strategies involving derivatives. If the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities, we may consider the registered adviser/portfolio manager to not be "in the business of advising others in relation to derivatives".

(a) Do you agree with this approach? If not, why not? Alternatively, should we consider including an express exemption from the derivatives adviser registration requirement for a registered adviser under securities or commodity futures legislation? If yes, what if any conditions should apply to this exemption?

(b) When should the provision of advice by a registered adviser/portfolio manager in relation to derivatives be considered incidental to the performance of their activities as a registered adviser/portfolio manager? What factors should we consider in distinguishing between registered advisers who need to register as derivatives advisers from registered advisers that do not need to register as derivatives advisers?

Answer:

It is CMIC's strong view that persons who provide advice in respect of OTC derivatives should not be required to register as CMIC is not aware of any other jurisdiction with this requirement. If the CSA is unwilling to accept this recommendation, then it is CMIC's strong view that a registered adviser under securities or commodity futures legislation should not be considered to be "in the business of advising others in respect of derivatives" (whether entered into for hedging or non-hedging purposes) where the performance of these activities is limited in nature so that it could reasonably be considered incidental to the performance of their activities as a registered adviser for securities. An example of such incidental activity is where the derivatives-related advice would not be reasonably considered by the derivatives party to be core to the overall investment activity that is employed for the derivatives party. This may be evidenced by the description of the derivatives-related investment activity that is or will be employed by the registered securities adviser for a derivatives party relative to the overall investment activity of the securities adviser that is employed for the derivatives party, either orally or as set out in an investment management agreement or offering documents that are provided or otherwise made available to the derivatives party.

CMIC also strongly recommends that the test for what is "incidental" not hinge on the frequency of transacting. Large buy-side institutions may engage in various types of OTC derivatives transactions with repetition, regularity or continuity for hedging purposes. For example, currency hedging may be done on a very frequent basis, however, it should still be considered incidental to activities of a portfolio manager or adviser.

CMIC is also of the view that it would be appropriate for the Proposed Rules to include an express exemption for a registered adviser under securities or commodity futures legislation in either of the following circumstances:

1) Where the registered adviser complies with the following conditions: (i) it has incorporated and applies risk management-related policies and procedures that substantially comply on an outcomes basis with Section 39 of the Proposed Rules, (ii) a "derivatives chief risk officer" (which could be the registered adviser's current CRO or CCO) is designated by the registered adviser and the derivatives chief risk officer complies on an outcomes basis with Section 29 of the Proposed Rules, and (iii) the initial and ongoing proficiency requirements that are set out in Section 18(1) of the Proposed Rules are complied with. If these conditions are met, then a registered adviser will have complied with the rule in spirit, and the incremental benefits associated with complete compliance with the rule do not outweigh the costs and other burdens of such compliance.

2) Where the registered adviser is only providing derivatives-related advice to a derivatives party that is acting as a commercial hedger (as defined in Section 1(1) of the Proposed Rules) in relation to the derivatives that it transacts, and such derivatives party is an "eligible derivatives party" as defined in Section 1(1) of the rule. It is CMIC's view that, taking into account the sophistication of the commercial hedger, the limited nature of the advisory activity that is undertaken by the registered adviser and the limited purpose of the advice, compliance with the Proposed Rules by the registered adviser will not add any necessary protections to market participants, and that the incremental benefits associated with compliance with the rule do not outweigh the costs and other burdens of such compliance.

5) IIROC membership for certain derivatives dealers

Q: Section 9 prohibits a derivatives dealer from transacting with an individual that is not an eligible derivatives party unless the derivatives dealer is a dealer member of IIROC. Should a derivatives dealer that deals with an individual that is not an eligible derivatives party be required to become an IIROC dealer member? Are there any other circumstances where a derivatives dealer should be required to be an IIROC dealer member?

Answer:

CMIC does not understand the rationale behind requiring derivatives dealers to be registered as an IIROC dealer in order to trade with an individual that is not an EDP. In CMIC's view, this is unduly restrictive and impractical and there should not be any restrictions in terms of categories of derivatives dealer that can enter into transactions with non-EDP individuals.

As an example of the impracticality of requiring non-EDP individuals to trade through an IIROC member firm, some Canadian banks have private banking and/or wealth management businesses where these clients are individuals who may not currently qualify as EDPs under the current proposal. Many of these clients are located in Asia and banks will book these transactions in their Asian branches. Assuming that the Proposed Rules will apply to these trades (which, for greater certainty and as explained in our Business Conduct Response Letter, the Proposed Rules should not apply to these trades), this would mean that (i) a client outreach would be required to determine whether these clients are EDPs and (ii) these trades would have to be entered into by an IIROC member. Obtaining written representations from private banking clients has always been problematic if other private banks have not requested similar information, as clients often bank with multiple banks. It would be highly unusual and impractical to require a Canadian bank to trade with non-EDP foreign individual clients through an IIROC member. We are not aware of any other global banks whose home regulators would require them to trade outside their home market through a home broker-dealer entity, which would then have to become licensed in these foreign markets. As a result, if the CSA's approach is taken, Canadian banks would be placed at a serious competitive disadvantage relative to other global banks. CMIC therefore strongly opposes the requirement that trades with non-EDP individuals be entered into through an IIROC dealer.

6) Exemption from the individual registration requirements for derivatives dealing representatives and derivatives advising representatives

Q: Subsection 16(3) and subsection 16(4) provide an exemption from the requirement to register an individual as a derivatives dealing representative or as a derivatives advising representative in certain circumstances. Are the exemptions appropriate? In subparagraph 16(4)(b)(ii), individuals that act as an adviser for a managed account are not eligible for the exemption from the requirement to register as a derivatives advising representative. Is this carve out appropriate where an individual has discretionary authority over the account of an eligible derivatives party?

Answer:

CMIC is of the view that the exemptions under Sections 16(3) and 16(4) are appropriate. EDPs do not need any added protection that would be provided when an individual is registered as a derivatives dealing representative or a derivatives advising representative, particularly, the specific course and examination requirements set out in Sections 18(4) and 18(6). Derivatives firms are still required to ensure that individuals acting on behalf of such derivatives firms have the proper education, training and experience that a reasonable person would consider necessary, as set out in Section 18(1). Given the sophistication of EDPs, this baseline proficiency requirement is sufficient.

With respect to managed accounts and the carve-out to the Section 16(4) exemption, it is CMIC's view that this carve out is not appropriate and that individuals who have discretionary authority over the account of an EDP should have the benefit of the exemption from the requirement to register as a derivatives advising representative. In CMIC's view, the underlying EDPs should not be treated like non-EDPs simply because they have chosen to purchase professional advice via a managed account arrangement. It is unclear why two EDPs should be treated differently simply because one EDP decides to enter into a contractually negotiated agreement with an adviser for a managed account, whereas another EDP that has the financial resources to enter into such an agreement chooses not to. We wish to highlight that advisers have a fiduciary duty to clients with managed accounts and therefore EDPs with managed accounts will have enhanced protection. CMIC therefore recommends that the carve out under Section 16(4)(b)(ii) be deleted.

7) Specific proficiency requirements for individual registrants

Q: Subsections 18(2) through (6) of the Instrument establish specific proficiency requirements for each individual registration category. Are these specific requirements appropriate? If not what specific exams, designations or experience are appropriate?

Answer:

CMIC is not aware of any other derivatives legislation (current or contemplated) that includes proficiency requirements as burdensome and involved as what is currently contemplated in Sections 18(2), 18(3), 18(4) and 18(6) of the Proposed Rules. We appreciate that the approach that the CSA has taken is inspired by Canadian securities legislation, however, the OTC derivatives market is substantially different and the costs and burden of complying with the proficiency requirements as currently written do not outweigh the benefits. In our view, the proficiency requirements that are set out in Section 18(1) should be sufficient and are consistent with IOSCO standards.

If the CSA does not agree to remove the proficiency requirements in Sections 18(2), 18(3), 18(4) and 18(6) for all categories of registration, then CMIC notes that the requirement under Section 18(4) with respect to derivatives dealing representatives appears to equate proficiency solely with education, whereas derivatives advising representatives satisfy the proficiency requirement under Section 18(6) through a combination of education and experience. In CMIC's view, an individual that is registered as a derivatives dealing representative or a derivatives advising representative should be able to satisfy the proficiency requirement through a combination of any one or more of education, training and experience. To clarify, if an individual has a certain number of years' experience in the derivatives industry, he or she should not be required to also pass a specified derivatives course in order to act on behalf of the derivatives firm. Further, there should be a transition period of at least three years from the date the Proposed Rules are finalized to the date they become effective in order to enable individuals in any category of registration to study for and complete the required exams.

CMIC notes that with respect to the specific courses listed in Section 18 of the Proposed Rules, these requirements should not be bespoke requirements. Instead, for liquidity and harmonization reasons, the only course requirement that should be listed is the proposed National Futures Association examination requirement commencing January 2020.

8) Derivatives ultimate designated person

Q: Subparagraph 27(3)(c)(i) requires a derivatives firm's ultimate designated person to report any instance of non-compliance with securities legislation, including the Instrument, relating to derivatives or the firm's risk management policies if the non-compliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?

Answer:

In CMIC's view, it is inappropriate and unnecessary to have a bespoke requirement that a firm's ultimate designed person ("**UDP**") is required to report to the board of directors any instance of non-compliance with the Proposed Rules, securities legislation relating to derivatives or the firm's risk management policies where non-compliance creates a risk of material harm to a derivatives party or the capital markets, or is a pattern non-compliance. Instead, the requirement should be that such a report be made under existing internal procedures (as required under prudential regulation, if applicable) which may include reporting by the CRO or the CCO. Further, any board reporting requirement should be fulfilled where such reporting is made to a management committee of the board of directors and not directly to the board of directors. Adding such a bespoke board reporting regime is not consistent with existing prudential regulation or global standards, or with Canadian securities legislation. Please see CMIC's response to Question 9 below in respect of the obligation of the UDP to report to the securities regulator.

In terms of the requirement that such non-compliance must create a "risk of material harm", it is CMIC's view that the "material harm" must be as a direct result of non-compliance, and not the result of the trade itself, such as economic terms and market factors. It is CMIC's view that the Companion Policy should clarify this point.

9) Requirements, roles and responsibilities of ultimate designated persons, chief compliance officers and chief risk officers

Sections 27 through 29 of the Instrument establish requirements, roles, and responsibilities of individuals registered as the ultimate designated person, the chief compliance officer and the chief risk officer for each registered firm. Considering the obligations imposed on senior derivatives managers in the Business Conduct Instrument, are the requirements, roles and responsibilities in sections 27 through 29 of the Instrument appropriate?

Answer:

Please refer to our discussion of the senior derivatives manager regime in our Business Conduct Response Letter. In terms of whether the requirements, roles and responsibilities in sections 27 through 29 of the Proposed Rules are appropriate, it is CMIC's view that they are largely duplicative. If a derivatives firm has a CRO and a CCO, there is no need to specifically designate a derivatives chief risk officer and a derivatives chief compliance officer. Doing so will result in oversight fragmentation. The CRO and the CCO already have responsibility of ensuring compliance with, respectively, a firm's policies and procedures for managing risks and for a firm's compliance with all existing legislation and regulation applicable to the firm.

With respect to the appointment of a derivatives ultimate designated person, in CMIC's view, this role is already being performed by the CCO, at least as these requirements relate to Canadian banks, who is responsible for oversight of monitoring and reporting on compliance matters for the firm as a whole, taking into account all of the firm's businesses and materiality for the entire firm. The CCO is independent of the derivatives business units and will be objective in determining when non-compliance is material and should be reported to a board's senior management committee or and/or the regulators. Instead of having the UDP report instances of non-compliance to securities regulators, as contemplated in Section 27(3)(d) of the Proposed Rules, this should be accomplished by having the CCO (in the case of a bank) deliver the annual compliance report to securities regulators as material non-compliance with securities legislation is one component of that report. Accordingly, the current compliance structure within Canadian banks is working well and designation of specific individuals to meet these roles would be duplicative. As it relates to Canadian banks, it is not clear to CMIC (i) why the proposed designation of a derivatives UDP, and derivatives-specific CRO and CCO are necessary and (ii) how it will improve the existing compliance structure within banks that is functioning well under OSFI oversight and supervision on a basis that is consistent with global standards.

Similarly, with respect to registered securities firms, it should be sufficient for the reporting that is currently contemplated as being the responsibility of the UDP to be the responsibility of the registered securities firm's CCO. This approach would be consistent with Part 5 of NI 31-103, in that the UDP's responsibilities under that instrument are limited to (i) supervising activities that are directed toward ensuring compliance with applicable law, and (ii) promoting compliance with applicable law. In contrast, the CCO's responsibilities under that instrument (and the Proposed Rules for that matter) include reporting. It is not clear to CMIC why registered securities firms can't continue to apply an approach that has been functioning well from a securities regulatory perspective.

Also, we note that the word "material" does not appear in Sections 27(3)(c), 27(3)(d) and 28(3)(c) of the Proposed Rules before the references to compliance with "this Instrument", which is inconsistent with the drafting of Section 32 of NI 93-101. The inclusion of Section 32 of NI 93-101 is duplicative and confusing and CMIC recommends that it be deleted, and that the word "material" be inserted where appropriate in the Proposed Rules.

Our comments here with respect to reporting matters to securities regulators are subject to our comments under "Information Given to Regulator" on page 7.

10) Minimum requirements for risk management policies and procedures

Q: Section 39 sets out the minimum requirements for risk management policies and procedures. Are any of the requirements inappropriate? Are the requirements for an independent review of risk management systems appropriate?

<u>Answer:</u>

As it relates to derivatives firms that don't qualify for substituted compliance or are not otherwise exempted from the registration requirement, CMIC recommends that such firm's risk management policies and procedures should permit reporting to a firm's senior management committee of the board of directors, rather than directly to the board of directors. In addition, the requirements under Section 39 should not apply to a registered derivatives dealer that is acting as an intermediary for a registered firm, nor should Section 39 apply to a registered derivatives adviser in the context of conducting advising activities with its clients.

In addition, CMIC makes the following recommendations with respect to Section 39:

(a) Under Section 39(3)(a), the words "specific derivatives or" should be deleted. It should be sufficient to identify the material risks of "types of derivatives" without including material risks of "specific derivatives". Imposing a requirement to identify material risks from a specific derivative suggests a level of analysis that must be undertaken for each and every trade, and this would add an unjustified compliance burden.

(b) Under Section 39(3)(d), the word "material" should be added before the words "and risk tolerance limits" in Section 39(3)(d).

(c) Under Sections 39(3)(f) and 39(3)(g)(iii), the board reporting requirement should be deleted and instead, a requirement to report to the derivatives CRO should be added. The more fulsome board reporting that is done by the CRO in accordance with Section 29(3)(d) should be sufficient.

(d) Under Section 39(3)(g), the words "material change to the registered derivatives firm's risk exposures" should be deleted. Risk limits will reflect what is acceptable to a firm from a risk perspective (taking into account changes in exposure) and it should be sufficient to report a material breach of a risk limit. Imposing a requirement to specifically monitor and report material changes to exposures adds an unnecessary compliance burden.

(e) Under Section 39(3)(g), the words “immediate report” should be changed to “timely report”, as this is more realistic and it is consistent with other reporting that must be made on a timely basis.

(f) Under Section 39(4), CMIC does not agree with this requirement for an independent review of risk management systems and strongly recommends that this requirement be deleted. This would significantly and unnecessarily add to the cost and burden of compliance, is not something that is required by other major global regulators for non-prudentially regulated derivatives firms and is duplicative of existing requirements for prudentially regulated derivatives firms.

11) Exemptions from the requirement to register for derivatives dealers with limited derivatives

Q: Sections 50 and 51 establish exemptions from the requirement to register for derivatives dealers that have a gross notional amount that does not exceed prescribed thresholds. These exemptions provide that derivatives dealers that have their head office or principal place of business in Canada must calculate their gross notional amount based on outstanding derivatives with any counterparty, regardless of where the counterparty resides. Derivatives dealers that have their head office and principal place of business outside of Canada would calculate their gross notional amount based on outstanding derivatives where the counterparty is a Canadian resident. Would this result in Canadian resident derivatives dealers being placed at a competitive disadvantage, particularly where foreign derivatives dealers may be exempt from regulatory requirements in their home jurisdiction?

Answer:

Yes, CMIC’s view is that the current formulation of the calculation of notional amount will place Canadian resident derivatives dealers at a competitive disadvantage. It is not clear why a distinction is being made here that foreign dealers can exclude OTC derivatives trading activity that occurs outside of Canada, whereas Canadian domestic dealers are not able to do the same. CMIC notes that this would be the case even if the foreign dealer is exempt from registration in its home jurisdiction and therefore such trades outside of Canada do not fall under regulatory supervision. What makes this distinction even more striking is the fact that trades of certain Canadian resident derivatives dealers with non-Canadian counterparties are already subject to regulatory supervision outside of Canada (such as trades between Canadian banks that are registered swap dealers and U.S. persons). Therefore, those trades are, in effect, being double counted. Accordingly, CMIC does not think there should be any distinction between a Canadian resident derivatives dealer and a foreign dealer and the methodology used to determine whether the *de minimis* threshold has been exceeded.

12) Exemptions from specific requirements in this Instrument for investment dealers

Q: Section 55 exempts IIROC dealer members from specific requirements under the Instrument where those dealer members are subject to equivalent IIROC requirements. The IIROC dealer members will also be required to register in each CSA jurisdiction where their activities result in an obligation to register as a derivatives dealer or derivatives adviser. Does this obligation to register result in an excessive regulatory burden for the firms? Please provide specific information relating to this burden.

Answer:

While CMIC has not performed a detailed analysis of equivalent IIROC requirements, CMIC supports exemptions for IIROC dealer members as such dealer members are subject to a fulsome registration and business conduct regime in accordance with the IIROC Dealer Member Rules, including requirements around designation of a chief compliance officer, minimum capital, financial reporting, maintenance of books and records, business continuity, and derivatives risk management. The CSA is encouraged to perform a detailed review of rules applicable to IIROC dealer members, and complete Appendix E to the Proposed Rules, with a view to granting substituted compliance on an outcomes basis.