sifma

asset management group

September 17, 2018

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

c/o Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax: 514-864-6381
consultation-en-cours@lautorite.qc.ca

c/o Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

Re: Comments with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct*, Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*, Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102 *Derivatives: Registration*

The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**" or "**AMG**") appreciates the opportunity to provide comments to the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-101 *Derivatives: Business Conduct* (the "**Business Conduct Instrument**") and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the "**Business Conduct CP**" and, collectively with the Business Conduct Instrument, the "**Business Conduct Rule**") and Proposed National Instrument 93-102 *Derivatives: Registration* (the "**Registration Instrument**") and Proposed Companion Policy 93-102 *Derivatives: Registration* (the "**Registration CP**" and, collectively with the Registration Instrument, the "**Registration Rule**")(collectively, the Business Conduct Rule and the Registration Rule, the "**Proposed Rules**").

SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG's members represent U.S. and multinational asset

management firms whose combined global assets under management exceed USD $39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. In their role as fiduciaries to investors and clients, AMG members use futures and cleared swaps, as well as other derivatives, for a range of purposes, including as a means to manage or hedge investment risks such as changes in interest rates, exchange rates, and commodity prices.

In transacting in derivatives for their clients, portfolio managers such as AMG members are entering into transactions with dealer counterparties on behalf of clients. The portfolio manager is not a principal in such a transaction – the risk and exposure related to the transaction lies with the dealer and the client, not the portfolio manager. Further, a portfolio manager acting on behalf of a client is governed by the client's investment mandate, which prescribes the concentration, risk, exposure, liquidity, leverage etc. limits on the client's account. The risk management systems of a portfolio manager are properly concerned with, and monitor for, limits, risks and exposure at a client account level. This contrasts with the risks and exposure of dealer firms, where the dealer itself faces risk and exposure of the transactions it enters into. It is this risk and exposure that is the more appropriate focus of business conduct and registration rules relating to derivatives.

The Proposed Rules significantly impact AMG members, including many that provide asset management services to Canadian clients on a cross-border basis. This is particularly the case given that the Proposed Rules do not include equivalents of the international sub-adviser exemption found in section 8.26.1 of NI 31-103 (the "**International Sub-Adviser Exemption**") and the international adviser exemption found in section 8.26 of NI 31-103 (the "**International Adviser Exemption**"). It is critical to our members that the Proposed Rules include exemptions mirroring the International Sub-Adviser Exemption and the International Adviser Exemption. Failing to include these exemptions in the Proposed Rules may limit the participation of foreign firms in the Canadian marketplace and therefore ultimately decrease choice and increase costs for Canadian market participants.

Given this and our below comments on the Proposed Rules, including the fact that the relevant Appendices for the exemptions available to foreign derivatives advisers under the Proposed Rules have not been made available to the public, a third round of consultation and comments on the Business Conduct Rule is necessary, as well as further consultation and comments on the Registration Rule to ensure a meaningful opportunity for comment. The transition periods for the Proposed Rules should sufficiently and fairly reflect these factors. Given that the majority of AMG members or their affiliates are non-Canadian firms, it is imperative that the Proposed Rules identify the jurisdictions that will provide a partial or full exemption in order to give market participants a sufficient opportunity to provide meaningful comments on the proposed exemptions. Because the Proposed Rules do not contain this material information, foreign firms are in a state of uncertainty as to whether they will receive, full, partial or no exemptions from the registration requirements. Without this critical information, foreign firms cannot determine how they will be impacted by the Proposed Rules and consequently, foreign firms are being deprived of the opportunity to provide meaningful comment on the Proposed Rules. Consequently, foreign firms will be forced to decide—without the benefit of important information—on the appropriate

course of action, which may include registering in Canada or ceasing its OTC derivatives operations in Canada.

We begin our comments with introductory thoughts on the Proposed Rules, followed by our comments that apply to both Proposed Rules and concluding with separate specific comments on each of the Business Conduct Rule and the Registration Rule. We also set out in Appendix "A" our responses to certain of the matters relevant to our members that the CSA has requested specific feedback with respect to the Business Conduct Rule and in Appendix "B" our responses to certain of the matters relevant to our members that the CSA has requested specific feedback with respect to the Registration Rule.

A. Introductory comments applicable to both of the Proposed Rules

Regulating dealers and market participants in OTC derivatives, who have not been subject to the same level of regulation as securities industry market participants, is the stated focus of the Proposed Rules:

> "During the financial crisis of 2008, some firms dealing in derivatives contributed to the crisis by not effectively managing their own derivatives related risks. The International Organization of Securities Commissions (IOSCO) noted in 2012 that "historically, market participants in OTC derivatives markets have, in many cases not been subject to the same level of regulation as participants in the traditional securities market. This lack of sufficient regulation allowed certain participants to operate in a manner that created risks to the global economy that manifested during the financial crisis of 2008." [*emphasis added*]

In contrast, securities advisers in Canada are, and have historically been, subject to extensive regulatory oversight.[1] Such advisers are currently subject to the requirements in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**").

NI 31-103 already provides an extensive, harmonized and comprehensive framework for the regulation of portfolio managers operating or conducting activities in Canada and it should remain the principal regulatory instrument for portfolio managers, even in the OTC derivatives space. Expanding the regulatory oversight of portfolio managers to the Proposed Rules is unnecessarily onerous and does not appear to be justified by any identified systemic risks created by ***portfolio managers*** in the Canadian marketplace.[2]

Further, applying the Proposed Rules will create an even more fragmented regulatory regime for portfolio managers in Canada. For instance, a foreign portfolio manager that proposes to advise an institutional client in Ontario with respect to securities, commodity futures and OTC derivatives, in reliance on registration exemptions, will have to be concerned with three separate regimes and three different sets of exemptions.[3]

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[1] In this letter, we use the term "portfolio manager" to refer to advisers registered or exempt under NI 31-103 and applicable commodity futures legislation (as context dictates).

[2] Notably and as cited in this letter, the implementation of the Proposed Rules is premised on risks created by dealers and market participants in OTC derivatives that have not been subject to the same level of regulation as securities industry market participants.

[3] These exemptions include: (i) in NI 31-103, the International Adviser Exemption and the International Sub-Adviser Exemption; (ii) under the *Commodity Futures Act* (Ontario) (the "**CFA**"), the discretionary exemptions that mirror the

Any exemptions in the Proposed Rules should mirror the existing rules pertaining to the International Adviser Exemption and the International Sub-Adviser Exemptions. Not only do the Proposed Rules not mirror the existing international exemptions, they fail to identify which jurisdictions are fully exempt from registration as well as those jurisdictions that are partially exempt and they introduce conditions that have not generally been seen in the Canadian securities regulatory landscape, including creating a new investor status and requiring registration in the relevant home jurisdiction, substituted compliance and notification to regulators of material non-compliance matters). The requirement for a firm to be registered in its home jurisdiction is particularly challenging for SEC-registered investment advisers, which are able to use derivatives in certain situations, while being exempt from the CFTC's Commodity Trading Advisor registration requirements.

This lack of harmonization with existing securities exemptions, combined with the proposed compliance requirements of the exemptions, may reduce the number of foreign portfolio managers willing to provide advisory services to Canadian clients and may reduce the amount of derivatives trading activity in Canada, thereby reducing liquidity.

For these reasons, we believe that the CSA must re-evaluate each of the following issues prior to its consideration of finalizing the Proposed Rules:

- The Proposed Rules should not apply to registered portfolio managers because they are already sufficiently regulated;

- Requiring comment on either the full or partial exemptions for foreign derivatives firms, as well as on various other parts of the Proposed Rules that have not been fully determined, deprives the CSA of the benefit of informed comment on those issues;

- The Proposed Rules deviate from international standards and risk harming cross-border activity, including reducing cross-border liquidity into Canada;

- To the extent that portfolio managers advising on OTC derivatives pose an identified and significant risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks instead of adding a new, separate regulatory regime under the Proposed Rules;

- The Proposed Rules (to the extent that they will apply to portfolio managers) should only impose the fundamental obligations found in Part 3 Division 1 of the Business Conduct Rule on portfolio managers (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party);

- To avoid cross-border issues and to improve harmonization, NI 31-103, or alternatively, the Proposed Rules (to the extent that they will apply to portfolio managers), should include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption; and

conditions of the International Adviser Exemption and the International Sub-Adviser Exemption; and (iii) the foreign derivatives adviser exemptions available under the Proposed Rules, which do not mirror the conditions of International Adviser Exemption and the International Sub-Adviser Exemption.

- The Proposed Rules should not adopt a new investor status in the "eligible derivatives party" definition and should not create new material reporting thresholds in the foreign adviser exemptions; instead, the Proposed Rules should apply the concepts already existing in the securities space.

While we have not commented on the specific dealer requirements in the Proposed Rules, we ask that you refer to the comments and concerns raised by dealers – to the extent that there are fewer dealers with whom advisers may transact as a result of the Proposed Rules, advisers will have difficulty in hedging risk and providing liquidity for their Canadian clients.

B. Comments applicable to both of the Proposed Rules

Application of the Proposed Rules to Portfolio Managers

1. Applying a new regime to portfolio managers is duplicative, unnecessary and unduly burdensome

Portfolio managers are already subject to extensive regulation. For instance, portfolio managers registered under NI 31-103 must establish and maintain significant policies, procedures and controls to manage the risks of their businesses and ensure compliance with securities legislation. The roles of a registered Ultimate Designated Person and a registered Chief Compliance Officer already exist to oversee portfolio managers' compliance systems. Each individual engaged in advising activities with the firm are already subject to registration requirements as well. Further, portfolio managers are already required to maintain minimum levels of capital, maintain extensive books and records, provide fulsome disclosure and reporting to clients, ensure fairness in allocating investment opportunities among clients, appropriately manage conflicts of interests and client complaints and avoid certain conflicted transactions, among other obligations, including maintaining insurance. In addition, portfolio managers that advise on exchange-traded derivatives are also subject to additional regulation in certain provinces under commodity futures legislation.

Layering additional yet largely duplicative regulation on portfolio managers that advise on OTC derivatives is unnecessarily burdensome and not in line with international standards, particularly those found in the United States. It is also out of step with recent regulatory burden reduction efforts by the CSA (for instance, see CSA Staff Notice 81-329 *Reducing Regulatory Burden for Investment Fund Issuers*).

2. Registered portfolio managers should be fully exempted from the application of the Proposed Rules and, to the extent that portfolio managers advising on OTC derivatives pose an identified risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks

Given the considerations above, registered portfolio managers should be fully exempted from the Proposed Rules. Otherwise, registered portfolio managers, in order to avoid the onerous application of the Proposed Rules, may limit their clients' access to certain OTC derivatives in Canada. The Proposed Rules may also drive foreign portfolio managers out of the Canadian marketplace, likely resulting in reduced investor choice in Canada and increased costs for both investors and Canadian firms.

To the extent that the CSA believes that portfolio managers, either registered or exempt, advising on OTC derivatives pose a residual risk to Canadian capital markets, appropriate revisions should be made to NI

31-103 to address such risks. For instance, the International Adviser Exemption and the International Sub-Adviser Exemption can be modified to be made available to foreign portfolio managers advising on OTC derivatives.

The "incidental" guidance in the Business Conduct CP and the Registration CP does not address these concerns. Such guidance is vague, difficult to apply in practice and does not provide sufficient clarity for market participants in determining whether they are subject to the registration requirement. Clear exemptions in each Proposed Rule is our preferred approach.

We also have a concern with respect to the product scope of the Proposed Rules. We understand that the Proposed Rules will apply to persons in the business of dealing in or advising on instruments as determined by the relevant derivatives product determination rule in each province and territory (the "Product Determination Rules"). Under the Product Determination Rules, foreign exchange contracts are "in scope" and therefore would be "in scope" for the purposes of the Proposed Rules.

Assuming that the Proposed Rules will apply to portfolio managers, the CSA should consider the instruments caught by the Product Determination Rules for the purposes of the Proposed Rules. In particular, foreign exchange contracts should not be "in scope" for the purposes of the Proposed Rules – these contracts do not present a systemic risk to Canadian capital markets. Foreign exchange contracts are commonly used by portfolio managers to hedge risks associated with their clients' investment portfolios (a necessary incidental aspect of managing a securities portfolio) and this activity should not subject a portfolio manager to the Proposed Rules.

The CSA contemplated that the application of the Product Determination Rules could vary depending on the particular regulatory instrument under consideration. For instance, the following is stated in CSA Consultation Paper 91-301 – *Model Provincial Rules – Derivatives Product Determination and Trade*:

> "The Committee expects that elements of the Scope Rule, subject to necessary amendments, will also be made applicable to certain provisions of securities legislation, and to additional derivatives rules that will be brought into force, including but not limited to rules relating to over-the-counter central counterparty clearing, end-user exemptions, trading platforms, capital and collateral, and registration. However, there may be variations in the application of the Scope Rule for these other rules. In particular, certain contracts or instruments that are prescribed to be securities or derivatives for the purposes of the TR Rule may be treated differently in other rules." [emphasis added]

3. If portfolio managers are not fully exempted from the application of the Proposed Rules and NI 31-103 is not modified, then portfolio managers should only be subject to the fundamental requirements in Part 3 Division 1 of the Business Conduct Rule

If portfolio managers are not fully exempted from the application of the Proposed Rules, then they should only be required to comply with the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party).

Application of the Proposed Rules to Foreign (Exempt) Portfolio Managers

We propose that NI 31-103, or alternatively, the Proposed Rules (to the extent that they will apply to portfolio managers), should simply include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption.

1. The foreign derivatives adviser exemptions in the Proposed Rules are overly burdensome and not sufficiently harmonized with existing international exemptions available under NI 31-103

Section 43 of the Business Conduct Rule and Sections 59 and 61 of the Registration Rule provide exemptions for foreign derivatives advisers from the Proposed Rules if certain conditions are met, including that the foreign derivatives adviser is subject to, and in compliance with, the laws of a specified foreign jurisdiction (to be set out in an appendix to each rule). Other conditions of certain of these exemptions include that the foreign derivatives adviser promptly notifies the applicable Canadian regulator of each instance of material non-compliance with a requirement or guideline of the foreign jurisdiction. A foreign derivatives adviser relying on one of these exemptions must still comply with certain of the requirements of the Proposed Rules, despite being subject to the regulation of the foreign jurisdiction.

For no clearly identified reason, the exemptions under the Proposed Rules are much more limited than the International Adviser Exemption and the International Sub-Adviser Exemption, as well as the corresponding discretionary exemptions under commodity futures legislation.

Further, these exemptions are premised on the concept of substantial compliance, which is a novel concept in the Canadian securities regulatory landscape, as is the requirement to notify the applicable Canadian regulator of instances of material non-compliance. Despite the guidance provided, this notification requirement is overly broad. With respect to the foregoing, we encourage the CSA to build in the following concepts:

(i) Notification should only be required if the matter giving rise to the non-compliance is material to, and affects, Canadian clients serviced under the relevant exemption;

(ii) It should be clear that notification to the Canadian securities regulators is to be given only after notification has been given to the foreign firm's regulator in its home jurisdiction; and

(iii) The form of filing that the foreign firm used in its home jurisdiction should be accepted by the CSA (e.g. if the matter required an update to a firm's Form ADV that was filed with the SEC, then the firm should be able to file the updated Form ADV as its notification to the Canadian securities regulators).

For these reasons, NI 31-103 or alternatively the Proposed Rules (to the extent that they will apply to portfolio managers) should include adviser registration exemptions that mirror the International Adviser Exemption and the International Sub-Adviser Exemption. One appropriate outcome we see from this approach is that an SEC-registered investment adviser whose principal office is outside of Canada would not be subject to the Proposed Rules when it provides investment advisory services which include OTC derivatives to Canadian funds and clients that are eligible derivatives parties. This outcome would be consistent with the approach to securities regulation under NI 31-103.

Finally, we reiterate that it is difficult to comment on the appropriateness of the foreign derivatives adviser exemptions in the Proposed Rules because the appendices of foreign jurisdictions have yet to be identified for comment. Foreign firms are not able to fully and properly assess how the Proposed Rules will apply to them, as they do not yet know the full extent of the requirements to which they will be subject. A process should also be built into each appendix to update the list of acceptable foreign jurisdictions in an efficient manner (with appropriate industry consultation and comment process) to avoid the appendices becoming static. This is important as regulation constantly evolves, often at a quick pace. A third round of consultation and comments on the Business Conduct Rule is necessary, as well as further consultation and comments on the Registration Rule.

2. *The International Sub-Adviser Exemption should be available to firms with respect to OTC derivatives activities*

It is critical that an equivalent of the International Sub-Adviser Exemption be available to firms with respect to OTC derivatives activities. It defies market efficiency and notions of cross-border harmonization to require a firm that is exempt from registration in Canada under the International Sub-Adviser Exemption for securities law purposes to have to both register as a derivatives adviser, and be subject to extensive business conduct requirements, simply for sub-advising on a mandate that includes OTC derivatives. The application of the International Sub-Adviser Exemption to OTC derivatives activities would help to address our harmonization concerns, as well as our concerns with respect to the compliance burdens. Failing to include such an exemption may also severely limit the participation of foreign firms in the Canadian marketplace.

The terms of the International Sub-Adviser Exemption available to firms with respect to OTC derivatives activities should be identical to the terms found in section 8.26.1 of NI 31-103. Therefore, if a firm qualifies under the International Sub-Adviser Exemption, it should not be subject to further Canadian securities regulatory requirements. This is justifiable from a policy perspective, as an international sub-adviser may only advise a registered Canadian adviser or dealer, specifically where that registered firm has agreed to be responsible for the losses arising out of the failure of international sub-adviser to fulfill its fundamental obligations.

3. *The International Adviser Exemption should be available to firms with respect to OTC derivatives activities*

Similarly, an equivalent of the International Adviser Exemption should be available to firms with respect to OTC derivatives activities. The terms of the International Adviser Exemption should mirror the terms found in section 8.26 of NI 31-103. No policy reason has been identified why such an exemption should not be available to firms that advise on OTC derivatives. Adopting such an approach promotes cross-border harmonization and marketplace efficiency.

4. *If the International Sub-Adviser Exemption and the International Adviser Exemption are not available to firms with respect to OTC derivatives activities, then foreign derivatives advisers should only be subject to the fundamental requirements in Part 3 Division 1 of the Business Conduct Rule*

If the International Sub-Adviser Exemption and/or the International Adviser Exemption are not included in NI 31-103 or the Proposed Rules, then foreign portfolio managers, who may be able to avail themselves

of the foreign derivatives adviser exemptions in the Proposed Rules, should only be required to comply with the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule (i.e., fair dealing, conflict of interest management and general/gatekeeper know-your-derivatives party).

Specifically, section 61 of the Registration Rule should be deleted in its entirety and section 59 of the Registration Rule and section 43 of the Business Conduct Rule should be modified to reflect that only the fundamental obligations of Part 3 Division 1 of the Business Conduct Rule apply to foreign derivatives firms relying on such exemptions.

Transition Periods Must Provide a Fair and Reasonable Opportunity for Derivatives Firms to Comply

Given that it is not yet clear what final obligations and requirements will apply to portfolio managers under the Proposed Rules, it is very difficult for us to comment on the reasonableness of the proposed one year transition period in the Business Conduct Rule. This is particularly true for portfolio managers in foreign jurisdictions yet to be identified in appendices to be published in the future. Given this, a one year transition period is not reasonable. Once the final obligations and requirements are known, we will be in a better position to comment on the appropriate length of the transition periods, one that will provide our members sufficient time to meet any new applicable requirements in the Proposed Rules.

C. Specific comments with respect to the Business Conduct Rule

As those foreign jurisdictions have yet to be identified for "substituted compliance" purposes, SIFMA AMG believes that the Business Conduct Rule should be published for a further comment period. SIFMA AMG may have additional comments on any future publications.

1. Derivatives Advisers should not be required to provide relationship disclosure information and tied selling disclosures or derivatives party statements

The requirements in section 17 and section 18 of the Business Conduct Rule should not apply to derivatives advisers because derivatives advisers that are registered portfolio managers are already subject to similar obligations under NI 31-103. These obligations will also result in unnecessarily duplicative information being provided to derivatives parties by derivatives advisers and derivatives dealers because where an adviser transacts in derivatives on behalf of its investor client, the transaction is executed between the investor and the dealer, not the derivatives adviser. Therefore, derivatives dealers are the appropriate entity to provide this information to derivatives parties.

Likewise, Section 28 of the Business Conduct Rule should not apply to derivatives advisers because derivatives advisers that are registered portfolio managers are already subject to similar obligations under NI 31-103. This obligation will also result in duplicative information being provided to derivatives parties by derivatives advisers and derivatives dealers because where an adviser transacts in derivatives on behalf of its investor client, the transaction is executed between the investor and the dealer, not the derivatives adviser. Therefore, derivatives dealers are the appropriate entity to provide this information to derivatives parties.

2. Division 2 – Derivatives party assets should be modified to take into account industry practice with respect to rehypothecation of collateral and margin

We have concerns with the CSA's approach to collateral generally and in the Business Conduct Rule in particular. Section 23 specifically contemplates an exception from the application of Division 2 if a

derivatives firm is subject to, and complies with, National Instrument 81-102 *Investment Funds* **("NI 81-102**") in respect of derivatives party assets. We also note that the recent custody amendments to NI 31-103 have introduced similar rules with respect to collateral and margin applicable to registered firms.

OSC Staff have concluded in the past that rehypothecation of collateral deposited by an investment fund with a counterparty is generally not permitted under NI 81-102, without distinguishing between variation and initial margin. In accordance with industry practice and prior advice from OSC staff, many investment funds take the position that variation margin is not subject to the collateral rules in NI 81-102 and that rehypothecation is permitted. This position should be clarified in all applicable rules, including NI 81-102 and NI 31-103.

We believe that the future rule dealing with margin and collateral requirements for non-centrally cleared derivatives is the more appropriate instrument to address collateral and margin requirements.

3. We continue to have serious concerns with the requirement for derivatives firms to have senior derivatives managers

Foreign advisers with a small number of Canadian clients will be reluctant to incur the cost and complexity of implementing such a regime solely for Canadian activities. This requirement does not exist on the securities side in Canada. While certain major jurisdictions, such as the United Kingdom, have a role similar to that of the senior derivatives manager, it is important to keep in mind the unique Canadian regulatory environment. Unlike the United Kingdom, NI 31-103 (and the Registration Rule) prescribe (or will prescribe) categories that require firms to register individuals in oversight and compliance roles. In such a regulatory environment, it is unduly onerous and unnecessarily duplicative to then require a firm to designate an additional un-registered individual who fulfils substantially the same role as these registered individuals.

To the extent that these multiple overlapping roles are maintained in the Proposed Rules, a Canadian derivatives adviser that is an affiliate of a global/foreign derivatives adviser, which maintains individuals in some of the proposed roles who act on a global basis, should be able to rely on such individuals to meet the requirements of the Proposed Rules.

D. Specific comments with respect to the Registration Rule

As the Proposed Rules have yet to identify which foreign jurisdictions satisfy "substituted compliance," foreign advisers have not been adequately informed as to which provisions of the Registration Rule they will be subject, SIFMA AMG may have additional comments on the next publication for comment of the Registration Rule.

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We would be happy to further discuss the issues identified herein at your convenience. If you have any questions, please contact Tim Cameron at 202-962-7447 or tcameron@sifma.org, Jason Silverstein at 212-313-1176 or jsilverstein@sifma.org, or Andrew Ruggiero at 212-313-1128 or aruggiero@sifma.org.

Respectfully submitted,

/s/ Timothy W. Cameron
Timothy W. Cameron, Esq.
Managing Director
Asset Management Group – Head
Securities Industry and Financial Markets Association

/s/ Jason Silverstein
Jason Silverstein, Esq.
Asset Management Group – Managing Director and Associate General Counsel
Securities Industry and Financial Markets Association

/s/ Andrew Ruggiero
Andrew Ruggiero
Asset Management Group – Associate
Securities Industry and Financial Markets Association

Appendix "A"

Specific Feedback on the Business Conduct Rule

Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Response: SIFMA AMG reiterates that it is important that the definition of "eligible derivatives party" include all persons and entities that qualify as "permitted clients" under NI 31-103. We do not believe a justification has been identified for excluding any category of "permitted client" from the definition of eligible derivatives party. A burden is imposed on the market by creating another investor status essentially identical to an existing one. We strongly urge that a new paragraph should be added to the definition of "eligible derivatives party" in each Proposed Rule that refers to the definition of "permitted client" under NI 31-103.

Further, specific knowledge and experience requirements should not apply in order for persons to qualify as eligible derivatives parties. This is not in line with international standards and will make it onerous for firms to onboard clients. We believe financial thresholds are sufficient to identify derivatives parties who are not in need of extra protections.

We also believe that the CSA should reconsider the $25 million net asset threshold in paragraph (m)(ii) of that definition and lower such threshold to $10,000,000. This approach would be consistent with the "eligible contract participant" definition under the US Commodity Exchange Act, which uses a USD $10,000,000 total asset test. This would help to address cross-border harmonization concerns and help to ensure that Canadian market participants are not placed at a competitive disadvantage.

Handling complaints

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

Response: No, the obligations in section 16 should not apply to eligible derivatives parties and should not apply to any foreign derivatives adviser relying on an exemption from the Business Conduct Rule. Further, the obligations in section 16 should not apply to registered portfolio managers, who are subject to the complaint handling obligations in NI 31-103.

Policies, procedures and controls

Subparagraph 30(1)(c)(iii) requires a derivatives firm to have policies, procedures and controls that are sufficient to assure that an individual who transacts or advises on derivatives for a derivatives firm, conducts themselves with integrity. Please provide any comments you may have relating to this requirement, specifically about any issues relating to the implementation of the requirement in its current form. We will consider these comments in assessing the impact of this requirement on derivatives firms.

Response: We are concerned that the regulatory burden associated with this new requirement will reduce the number of foreign portfolio managers willing to provide advisory services to Canadian clients. To that end, foreign derivatives advisers relying on an exemption from the Business Conduct Rule should not be subject to this requirement. Further, this obligation should not apply to registered portfolio managers, who are subject to the obligations in Part 11 of NI 31-103. Portfolio managers, both Canadian and foreign, are subject to extensive regulation, including the requirement to have appropriate policies, procedures and controls in place.

Appendix "B"

Specific Feedback on the Registration Rule

1) Methodology for determining "notional amount"

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.**

Response: The "notional amount" methodology that is ultimately adopted for purposes of the Registration Rule may not necessarily be appropriate in other contexts or rulemakings. The appropriate methodology for determining "notional amount" should be tailored to the specific rule in which it is applied, with appropriate industry consultation prior to introduction of the methodology in that rule.

Definition of "eligible derivatives party"

Paragraphs (m), (n) and (o) provide that certain persons and companies are eligible derivatives parties if they meet certain criteria, including meeting certain financial thresholds. Are these criteria appropriate? Please explain your response.

Response: Please see the response above in Appendix "A".

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

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?**

Response: We have addressed this comment extensively in the body of our comment letter above. Portfolio managers should be exempt from the application of the Proposed Rules. In particular, please refer to "Section B. Comments applicable to both of the Proposed Rules - 1. Applying this new regime to portfolio managers is unnecessary and 2. Registered portfolio managers should be fully exempted from the application of the Proposed Rules and, to the extent that portfolio managers advising on OTC derivatives pose an identified risk to Canadian capital markets, appropriate revisions should be made to NI 31-103 to address such risks" above.

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

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)(iii), 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?

Response: SIFMA AMG supports the inclusion of these exemptions. Consistent with the removal of subsection 7(3) from the initial version of the Business Conduct Rule, which required managed accounts of eligible derivatives parties to be treated as those of non-eligible derivatives parties, subparagraph 16(4)(b)(iii) should be removed from the Registration Rule.

Specific proficiency requirements for individual registrants

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?

Response: The specific proficiency requirements for each individual registration category should be aligned with the corresponding specific proficiency requirements found in NI 31-103. In the alternative, individuals currently registered under securities or commodity futures legislation should be grandfathered under any new requirements under the Registration Rule.

Derivatives ultimate designated person

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?

Response: No. This requirement is out of step with the obligations of the ultimate designated person under NI 31-103. It is not clear to us why this requirement would be introduced for firms dealing in or advising on OTC derivatives when it is not required for firms dealing in or advising on securities.

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?

Response: Foreign advisers with a small number of Canadian clients will be reluctant to incur the cost and complexity of implementing such a regime, and hiring required individuals for these overlapping roles, solely for Canadian activities. Further, this additional compliance overlay is inappropriate for portfolio managers, which will be arranging for transactions through dealers, which are or will be required to have such personnel. Applying similar requirements to portfolio managers creates unnecessary duplication. Please also see the body of our response where we express concerns with these multiple overlapping roles under "Section C. Specific comments with respect to the Business Conduct Rule - 4. We continue to have serious concerns with the requirement for derivatives firms to have senior derivatives managers".

Minimum requirements for risk management policies and procedures

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?

Response: The requirement that risk management policies and procedures be approved by the derivatives firm's board of directors, or individuals acting in a similar capacity for the firm, is inappropriate. While we acknowledge that this requirement is similar to what swap dealers are subject to in the United States, it

is inappropriate as directors do not have the necessary qualifications or experience to assess such policies and procedures. To meaningfully meet this requirement, the directors would have to be risk management professionals. Directors, very likely being non-risk management professionals, will have to extensively consult the firm's risk management personnel to be in a position to meaningfully review and approve these policies and procedures. The board's role should properly be to ensure that an appropriate risk management system is in place and supervise this system (receiving regular reports from appropriate risk management personnel) but it should not be to approve risk management policies and procedures. Directors do not have the experience or expertise to appropriately provide such approval. The review and approval of risk management policies and procedures is the proper domain of risk management professionals, who have the necessary experience and expertise to conduct such a review.

The requirement for an independent review of risk management systems is unnecessary as firms will update and review such systems when appropriate (given their internal risk management processes and business and operating environment) and in line with their general duties and obligations, including to clients. This requirement is also out of line with the requirements applicable to compliance systems generally (i.e., there is no requirement for an independent review of compliance systems).