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Dear Sirs/Mesdames:

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

This comment letter is submitted on behalf of the Canadian division ("AIMA Canada") of the Alternative Investment Management Association ("AIMA") and its members to provide our comments to you on the legislative proposals referred to above.

About AIMA

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management (covering primarily hedge funds, private credit, liquid alternative funds and now also digital assets). AIMA is a not-for-profit international educational and research body that represents practitioners in alternative investment funds, futures funds and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting.

AIMA's global membership comprises approximately 2,100 corporate members in more than 60 countries, including many leading investment managers, professional advisers and institutional investors and representing over $2.5 trillion in assets under management. AIMA Canada, established in 2003, has approximately 140 corporate members.

Under our pillars of Advocacy, Education and Communication, the objectives of AIMA are to provide an interactive and professional forum for our membership; act as a catalyst for the industry's future development; provide leadership in sound practices; enhance industry transparency and education; and liaise with the wider financial community, institutional investors, the media, regulators, governments and other policy makers.

The majority of AIMA Canada members are managers of alternative investment funds and fund of funds. Most are small businesses with fewer than 20 employees and $50 million or less in assets under management, though some are some of our country's largest traditional asset managers. The majority of assets under management are from high-net-worth investors and are typically invested in pooled funds managed by the member.

Investments in these pooled funds are sold under exemptions from the prospectus requirements, mainly the accredited investor and minimum amount investment exemptions. Manager members also have multiple registrations with the Canadian securities regulatory authorities: as Portfolio Managers, Investment Fund Managers, Commodity Trading Managers and in many cases as Exempt Market Dealers. AIMA Canada's membership also includes prime services, custodial, accountancy and law firms with practices focused on the alternative investments sector.

For more information about AIMA Canada and AIMA, please visit canada.aima.org and www.aima.org.

Comments

We are writing in response to the Notice and appreciate the opportunity to share our views on behalf of our members. The majority of AIMA members will be impacted by the Notice as potential derivatives advisers, not as derivatives dealers.

We commend the CSA for their continuing analysis and consultation with respect to the issues and potential regulatory responses regarding the regulation of over-the-counter ("OTC") derivatives. We appreciate the amendments that (i) exempt registered advisers from certain requirements of the Notice if they comply with corresponding requirements in NI 31-103; and (ii) apply the senior derivatives manager requirements only to derivatives dealers.

AIMA Canada agrees that enhanced regulatory oversight of the OTC derivatives market is constructive. We urge the CSA, however, to consider all regulatory developments, both internationally and domestically, and consider their effect on investors and advisers before imposing a potential additional layer of regulatory requirements that may in fact be unnecessary or the cost of which may outweigh the intended benefits.

Our comments are organized as general comments and specific items pursuant to the Notice and separate responses regarding questions posed by the CSA in the Notice.

General Comments

1. **Registration as a Derivatives Adviser and Status of National Instrument 93-102 *Derivatives: Registration* and Companion Policy ("NI 93-102")**

We note that it is difficult to provide fulsome comments on the Notice without understanding the status of, or seeing any update of, NI 93-102 regarding when a firm is considered to be a derivatives adviser. The Notice outlines the impacts of being registered without the reader being clear as to when it applies. For example, the Notice does not indicate that there will be any exemption from registration as a derivatives adviser if activities are incidental. Although various comments in the Notice refer to what activities might trigger registration as a derivatives adviser, we urge the CSA to issue an update for the re-issuance of NI 93-102 for comment as soon as possible. The Notice must allow for further

comments depending on the contents of the revised NI 93-102. We believe that the CSA should implement proposed NI 93-101 and NI 93-102 at the same time, with identical transition periods to avoid causing confusion and uncertainty in the industry.

In the Notice the discussion of business purpose triggering registration as a derivatives adviser (page 13 of Annex D Companion Policy) states that "a registered adviser under securities or commodity futures legislation that provides advice to an investment fund or another person or company in relation to derivatives or derivatives trading strategies" may be considered to be in the business of advising others in relation to derivatives.

The use of the word "may" and the remainder of the discussion in the Notice regarding derivatives adviser registration is critical to our members. While we appreciate the revisions to the Notice exempting derivatives advisers from various provisions as long as they comply with similar provisions in NI 31-103, we reiterate our response to CSA Question #4 in our letter of September 2018. In our response we outlined conditions when derivatives advising activity should be considered incidental to a registered securities adviser activity and derivatives adviser registration would not be required. We note that our recommendation for exemption in the case of derivatives being used for hedging purposes is consistent with the definition of a commercial hedger in the Notice being subject to lesser requirements. For ease of reference, we have provided our 2018 comments in Appendix A attached.

In the Notice the CSA responded to comments regarding Question #4 from 2018. The CSA commented that it does not support a complete exemption for registered advisers as it has concerns that this would:

a) Create regulatory gaps and uncertainty, i.e., "because certain requirements in NI 31-103, such as the know-your-client (KYC) and suitability requirements in Part 13 of NI 31-103 and the client disclosure requirements in Part 14 of NI 31-103, are framed in terms of "purchases" and "sales" of "securities" rather than "transactions" in "derivatives". We also believe it would create significant regulatory uncertainty to regulate certain types of OTC derivatives as securities for registered advisers but as derivatives for investment dealers and other derivatives dealers."

   We submit that as registered advisers are exempted from Division 2 of Part 3 of the Notice re KYC, suitability and referrals under s. 45 of the Notice, the CSA has already chosen in certain instances to regulate derivatives within the existing securities framework. The existing regulatory framework has served investors well and it would create greater uncertainty if registered advisers who chose not to bear the additional regulatory burden of derivatives compliance were to suddenly cease using hedging strategies that have benefited investors. We would also note that, by providing exceptions from the business conduct rule to registered advisers, OTC derivatives are not being "reclassified" as securities. These exceptions merely provide that, as a registered adviser is already subject to compliance obligations and oversight, any risks of its OTC derivatives activities are mitigated and do not need to be duplicated in proposed NI 93-101.

b) Result in inconsistent treatment between different categories of registered firms that perform similar activities, i.e., "For example, both registered advisers and investment dealers/IIROC members advise funds and manage accounts that may contain OTC derivatives. We believe it would create significant regulatory uncertainty to regulate derivatives advisers as securities advisers and investment dealers/IIROC members as derivatives dealers for the same managed account activities."

   Similar to (a) above we submit that there is no regulatory uncertainty for industry participants. When investment dealers/IIROC members are managing accounts where they are acting in an advisory capacity, the same as a securities adviser.

c) Result in increased regulatory burden for registered advisers, i.e., "because, in many respects, the proposed derivatives rules represent a "lighter regulatory touch" than NI 31-103. For example, the EDP definition in the derivatives rules includes a "commercial hedger" category that is not included in the "permitted client" definition in NI 31-103."

   We submit that there is little to no increased regulatory burden for our members as investment funds are included in the definition of both EDP's and permitted clients.

2. Treatment of FX Forwards

We note that the Notice would continue to apply to FX Forward contracts, as determined by OSC Rule 91-506 *Derivatives: Product Determination* ("91-506") and similar rules in other jurisdictions.

In our 2018 letter AIMA, along with other commenters, recommended that the CSA exempt from application of the Notice any registrant who engages solely in FX Forward transactions, within defined parameters, used for hedging and risk management and not speculative purposes. This exemption would be consistent with the treatment of FX Forwards by other regulatory and oversight authorities, notably the U.S. Department of the Treasury, the BIS Committee and IOSCO. For ease of reference, we have provided our 2018 comments in Appendix A attached.

In the Notice the CSA responded to this recommendation with the comment "Since the financial crisis, there have been numerous cases of serious market misconduct in the global derivatives market and short-term FX market; for example, misconduct relating to the manipulation of benchmarks and front-running of customer orders, breaches of client confidentiality and failure to adequately manage conflicts of interest. Therefore, we remain of the view that FX transactions should be subject to the core business conduct obligations of the rule."

We agree with the CSA response generally, however physically-settled foreign exchange forwards have not been linked to market misconduct. These are products designed very specifically for hedging, are not significant sources of systemic risk and present minimal opportunities for abuse.

Accordingly, we reiterate our recommendation that the CSA exempt from the application of the Notice (and NI 93-102) any registered adviser who engages solely in FX Forward transactions within the following parameters:

(i) FX Forwards are used for risk management or hedging purposes connected to securities advising activities or investment fund structure, which would be consistent with the lighter touch regulatory treatment accorded commercial hedgers;

(ii) The FX Forward contracts have fixed terms requiring a physical exchange of currency; and

(iii) The average maturity of the portfolio of FX Forwards of the registrant is less than one year.

Specific Comments

1. Notice Part 5 Section 30 Policies and procedures

Under the Notice registered advisers are required to comply with Section 30 regarding policies and procedures. This section is specifically excluded from the exemptions available to registered advisers under Section 45. We have the following comments with respect to the provisions of Section 30:

> Subsections (a) and (b) are basically consistent with NI 31-103 Section 11.1 (1). However, we recommend that Section 30 (b) of the Notice be amended to be consistent with NI 31-103 Section 11.1 (b), i.e., "the risks relating to its derivatives activities within the derivatives business unit are managed appropriately and in accordance with <u>prudent business practices</u>."

This revised wording better encompasses the range of risks inherent in a business.

Subsection (c) (i) is basically consistent with NI 31-103 Section 3.4 (1) regarding initial and ongoing proficiency of registered individuals.

Subsection (c) (ii) is basically consistent with the know your product provisions of NI 31-103 Section 13.2.1 (2) for registered individuals.

Subsection (c) (iii) duplicates the requirements of Section 8 of the Notice and should be removed. This duplication is supported by the commentary in the Companion Policy (pg. 16) that "We expect individuals performing such activities to conduct themselves with integrity, which includes honesty and good faith, particularly in dealing with clients."

Given the above we recommend that the CSA include in Appendix F an exemption from Part 5 [*Compliance and recordkeeping*], other than section 30 [Policies and procedures] as it would apply to non-registered individuals. Please also see our response to CSA question #7 below.

2. Notice Section 34 Records

We recommend that this section be amended to be similar to NI 31-103 Section 11.5 (1), with specific enumerated requirements listed in a subsection 2 if desired. This would be consistent with the approach of keeping the Notice consistent with NI 31-103 as much as possible for consistency of regulatory regimes.

3. Notice Section 37 End User Exemption

We recommend that paragraphs (d) and (e) of subsection 37(1) be removed or at least be modified to exclude transactions arranged by a person for its affiliates. We are concerned that phrases such as "facilitate" and "or otherwise intermediate" are broad and could inadvertently subject end users to the rule.

Comments re CSA Questions

We have outlined below our comments with respect to CSA questions (number references are as per the Notice) that we consider broadly applicable to our members.

1. Foreign Liquidity Provider Exemption
In favour.

2. Foreign Derivatives Dealer & Foreign Derivatives Advisor Exemptions – Comparability Determinations
In favour, so long as there is a level playing field. To the extent foreign advisers are not subject to any requirements to follow derivatives business conduct rules with respect to FX Forwards, Canadian advisers should not be required to follow such rules.

3. Foreign Derivatives Dealer Exemption – Requirements
No Comment.

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

5. Exemptions from the Designation and Responsibilities of a Senior Derivatives Managers
In favour of not having SDM responsibilities apply to advisers.

6. ***Short-Term FX Contracts in the Institutional FX Market***
   No comment.

7. ***Treatment of Registered Advisers under Securities or Commodity Futures Legislation (pg. 11)***
   We appreciate the CSA exemptions under Section 45 for registered advisers. We agree that compliance with corresponding obligations of NI 31-103, with no to little amendment, helps in reducing regulatory burden while maintaining investor protection and applaud this approach.

   Consistent with this approach we recommend that the CSA add an exemption from Division 1 of Part 3 to Section 45. The requirements of this section have clear analogues in regulations applicable to registered advisers, specifically:

   Notice Section 8 Fair dealing – This section matches the requirements outlined in the NI 31-103 Companion Policy comments (pg. 57) regarding Section 13.4.1 Material Conflicts of Interest that identifying, addressing and disclosing material conflicts of interest 'is also consistent with the registrant's obligation to deal fairly, honestly and in good faith with its clients." We note that for Ontario registered advisers this obligation is also in OSC Rule 31-505 *Conditions of Registration*.

   Notice Section 9 Conflicts of interest – This section matches the requirements of NI 31-103 Sections 13.4 and 13.4.1. This recommendation is reinforced by the fact that the Notice states that "Section 9 of the Instrument was developed with the intention that it would be generally consistent with the conflicts of interest provisions of NI 31-103…. We are considering further changes to conform the conflicts of interest requirements so that they are consistent with those in NI 31-103, along with other changes to conform the requirements to be consistent with the requirements found in Client Focused Reforms." Given this policy direction we submit that registered advisers in compliance with these provisions of NI 31-103 have more than met the requirements. Please see our comments below re Conflicts of Interest.

   Notice Section 10 Know your derivatives party – The requirements of this section are clearly consistent with the Know Your Client provisions in Sections 13.2 of NI 31-103.

8. ***Conflicts of Interest ("COI")***
   We strongly recommend that the CSA conform the COI provisions of the Notice with the provisions of NI 31-103. It would remove or lessen regulatory uncertainty arising from two sets of regulations that will be largely applicable to the same group of entities and individuals.

   Specifically:
   - Notice Section 9 (1) could be replaced with NI 31-103 Section 13.4 (1).
   - Notice Section 9 (2) could be replaced with NI 31-103 Section 13.4 (2) and (3).
   - Notice Section 9 (3) could be replaced with NI 31-103 Section 13.4 (4) and (5).
   - We recommend that the comment in the Notice Companion Policy regarding disclosure of COIs on an annual basis be replaced with the discussion from the NI 31-103 Companion Policy regarding Timing of Disclosure.

* * *

We appreciate the opportunity to provide the CSA with our views on this consultation. Please do not hesitate to contact the undersigned with any comments or questions that you might have. We would be pleased to meet with you to discuss our comments and concerns further.

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION CANADA

Ian Pember, Glen Williams Consulting

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Claire Van Wyk-Allan, AIMA

APPENDIX A – AIMA Canada Comments September 2018 re Derivatives Proposals

Response to CSA Registration Proposal Q#4 - Application of derivatives adviser registration requirement to registered advisers/portfolio managers under securities legislation

Registered advisers under securities or commodity futures legislation ("securities advisers") should not be required to register as derivatives advisers where their advice with respect to derivatives is incidental to their securities advising because it is important to ensure (i) that the designation as a derivatives adviser is meaningful and does not automatically require all securities advisers to also register as derivatives advisers, (ii) that registration as a derivatives adviser is required only where such registration satisfies some regulatory vacuum, such as proficiency or investor protection, and (iii) on a cost-benefit analysis, any additional regulatory burden is not lightly imposed on participants in the investment management industry. Securities advisers and other participants in the asset management industry are already subject to constantly changing, overlapping and costly regulation across multiple jurisdictions.

We recommend that the CSA provide an express exemption from the derivatives adviser registration requirement for the benefit of the following three categories of securities advisers. Those managers of investment funds and accounts that (i) enter into derivatives transaction for the purpose of hedging against a particular identified risk that is inherent in the securities or other assets in which they typically invest, such as interest rate and currency exposures (to the extent that FX Forwards are not exempted as set out above), (ii) enter into one or more derivatives transactions for the purpose of obtaining a long or short exposure to the securities or other assets in which they typically invest directly, such as an equity swap, and (iii) otherwise enter into derivatives that are incidental or ancillary to their stated investment strategy. Many securities advisers that manage investment funds and accounts need to maintain the flexibility to enter into derivatives transactions to hedge against certain risks inherent in their respective portfolios and would benefit from having the ability to use derivatives to obtain exposure to a particular asset in the class of assets in which they typically invest. However, given a securities adviser's obligations to its clients under existing rules, it would be redundant to also require a securities adviser to also register as a derivatives adviser.

In order to qualify for such an exemption, the securities adviser should be required to enter into the trade with a registered derivatives dealer or a domestic or international derivatives dealer that is exempt from registration (including a federally regulated financial institution where such entities are exempt from registration). An additional requirement for relying on this exemption is that the stated investment strategy of the applicable investment fund or managed account should expressly provide in writing the core investment strategy and should include disclosure of the circumstances where the securities adviser may use derivatives pursuant to the exemption referred to in the Registration Proposal. In furtherance of this exemption, and to enhance the protection of the investors and beneficial owners of the funds and managed accounts, the definition of "eligible derivatives party" should be amended in the Business Conduct Proposal so that investment funds and managed accounts advised by a securities adviser (in (k) and (l) of the definition) are not included in the definition. In the alternative, such investment funds and managed accounts should have to elect to be treated as an eligible derivatives counterparty. The later approach is probably appropriate for all of the parties that constitute eligible counterparties after part (c). Many of the parties referred to in (d) to and including (l) may benefit from the additional protections afforded to parties other than eligible derivatives parties under the Business Conduct Proposal.

Exemption of Foreign Exchange Forward Contracts and Swaps ("FX Forwards") from the Proposals

The Proposals apply to OTC derivatives as defined by the various provincial regulations. In Ontario, OSC Rule 91-506 Derivatives: Product Determination effectively defines FX Forwards as OTC derivatives (which is consistent with the product determination rules in all other Canadian

jurisdictions). Notwithstanding this definition, AIMA Canada recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within defined parameters which are set out below.

For the purposes of regulation, FX Forwards have been excluded from the definition of OTC derivatives, for the purposes of regulation, by other regulatory and oversight authorities. We recommend that this approach be followed by the CSA for both international consistency and to maintain the competitiveness of the Canadian investment industry.

- In November 2012, the U.S. Department of the Treasury issued a final determination that FX Forwards would be exempted from certain mandatory derivatives requirements as part of the implementation of the Dodd-Frank Act. As a result, the U.S. Commodity and Futures Trading Commission ("CFTC") exempted FX Forwards from various monitoring and reporting requirements.
- In March 2015, the Basel Committee on Banking Supervision (the "BIS Committee") and the International Organization of Securities Commissions ("IOSCO") issued a paper on Margin Requirements for Non-Centrally Cleared Derivatives. In Requirement 1, paragraph 1.1, of this paper the BIS Committee and IOSCO state that "The margin requirements described in this paper do not apply to physically settled FX forwards and swaps."
- In February 2017, the Office of the Superintendent of Financial Institutions exempted physically-settled FX Forwards from the requirement to deliver initial and variation margin in Guideline E-22 *Margin Requirements For Non-Centrally Cleared Derivatives*.

With respect to the FX Forwards market, the above exclusions were deemed acceptable in light of the following factors with respect to the FX Forwards market:

a) Foreign exchange is unique as an OTC derivative in that the vast majority of FX transactions are short-term, thereby posing significantly less counterparty risk requiring oversight and regulation.

b) Foreign exchange transactions worldwide are already subject to strong, internationally coordinated oversight through central banks, with a well-functioning settlement process.

c) The transactions are often closely tied to the participants' funding and liquidity management activities.

d) Physically settled foreign exchange transactions should be viewed as money market or funding products. By definition such transactions are an agreement to deliver the full principal amount of one currency in exchange for the full principal amount of another currency. There are no "derivative" aspects to these transactions as participants know the exact extent of their obligations throughout the life of the contract.

Given these factors, AIMA recommends that the CSA exempt from the application of the Proposals any registrant who engages solely in FX Forward transactions within the following parameters:

a) FX Forwards are used by an entity registered as a securities adviser for risk management or hedging purposes linked to securities advising activities;

b) The FX Forward contracts have fixed terms requiring a physical exchange of currency; and

c) The average maturity of the portfolio of FX Forwards of the registrant is less than one year.