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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

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Dear Sirs/Mesdames:

**Re: CSA Notice and Request for Comment – Proposed National Instrument 93-102  
*Derivatives: Registration and Proposed Companion Policy 93-102CP Derivatives:  
Registration***

The International Swaps and Derivatives Association, Inc. (“**ISDA**”)<sup>1</sup> has been actively engaged for many years with providing input on regulatory reforms impacting derivatives in major jurisdictions globally, including Canada. ISDA appreciates the opportunity to provide comments to the Canadian Securities Administrators (“**CSA**”) in response to the notice and request for comments (the “**Notice**”) regarding the above-noted Proposed National Instrument 93-102 – *Derivatives: Registration* (the “**Proposed Instrument**”) and Companion Policy (“**CP**” and, together with the Proposed Instrument, the “**Proposed**

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<sup>1</sup> Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s web site: [www.isda.org](http://www.isda.org).

**Registration Rule**”). In this letter, ISDA wishes to outline areas that require further scrutiny and revision, in addition to our responses to the specific questions posed by the CSA in the Notice, which are included in Schedule A. This comment letter and ISDA’s comment letter on the revised Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (The “**Proposed Business Conduct Rule**”) should be read together given the many overlapping issues in the two instruments.

As a general comment, ISDA encourages the CSA to consult widely with relevant stakeholders to ensure that Canada adopts a derivatives registration framework that is directly responsive to local derivatives markets. In particular, this means that Canada should consider derivatives registration rules that are designed specifically for derivatives markets, not securities markets. We note that the structure and much of the content of the Proposed Registration Rule is drawn from the existing securities regulatory regime for registration and regulation of securities dealers and securities advisers. The CSA should consider all comments on the Proposed Registration Rule with the understanding that derivatives markets and securities markets are fundamentally different and accordingly require different regulatory regimes. Although ISDA refers to analogous concepts of the existing securities registration regime in this comment letter, our view, based on the global derivatives reform experience, is that the better approach is to develop a derivatives registration regime that is developed from, and tailored to, the realities of the Canadian derivatives market.

We are concerned that the derivatives registration framework in the Proposed Registration Rule does not address the realities of the local Canadian derivatives market, the majority of which is cross-border. If the Proposed Registration Rule is adopted as drafted, the Canadian derivatives market could suffer the fragmentation and decreased liquidity that occurred in the global derivatives market after the introduction of derivatives trading rules.<sup>2</sup> This would clearly be an unintended consequence of the type that Canadian regulators have long sought to avoid. We refer to the Discussion Paper entitled “Reform of Over-the-Counter (OTC) Derivatives Markets in Canada”<sup>3</sup> published in 2010 by the OTC Derivatives Working Group, which included members of the CSA. As described in the Discussion Paper, the OTC Derivatives Working Group was tasked with helping to ensure that Canada met its G-20 commitments “in a manner consistent with the continued stability and vibrancy of the Canadian financial system”. Canada has met or is meeting its G-20 commitments with respect to standardization, central clearing, trade reporting and transparency. Respectfully, the rationale for many aspects of the Proposed Registration Rule have not been clearly demonstrated, considering the potential risks to the stability and vibrancy of the Canadian financial system in the event that already regulated derivatives

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<sup>2</sup> See *ISDA Research Note: Cross-Border Fragmentation of Global Derivatives: Second half 2015 Update*, available on <https://www.isda.org/a/OSiDE/fragmentation-final1.pdf>

<sup>3</sup> Available on <https://www.bankofcanada.ca/wp-content/uploads/2010/10/reform.pdf>

dealers and derivatives advisers withdraw from, or substantially limit their exposure to, the Canadian derivatives market.

ISDA therefore urges that any Canadian derivatives registration rules should align with other jurisdictions of comparable size and with similar counterparty types, such as Australia. We are very concerned about the negative impact on Canada's derivatives market if Canada were to have a derivatives registration regime that goes further than IOSCO's and the G20 recommendations for derivatives market reform and goes further in many respects than the swap dealer registration rules promulgated by the U.S. Commodity Futures Trading Commission ("CFTC"). The Canadian market, which is largely an institutional market, relies on foreign markets for liquidity. The derivatives registration regime should reflect this reality.

Also, ISDA strongly recommends that the CSA prioritize harmonization of concepts in the Proposed Registration Rule with other concepts that are commonly used in the industry. As a tangible example, and as more fully discussed in the Appendix, ISDA believes that the CSA should include, in the definition of eligible derivatives party ("**EDP**"), any person that is (i) a "permitted client" as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("**NI 31-103**") and not an individual and (ii) an "eligible contract participant" as defined in Section 1a(18) of the U.S. *Commodity Exchange Act* (the "**CEA**"). This harmonization would help reduce the need for Canadian market participants to obtain separate compliance documentation for many clients. The experience with Canadian trade reporting rules demonstrated the difficulty in obtaining Canadian-specific client documentation even where the underlying rules were similar in purpose to G20 trade reporting rules.

To reiterate, the Proposed Registration Rule presents significant liquidity risks to the Canadian derivatives markets. ISDA described these risks in detail in our comment letter on the 2013 *CSA Consultation Paper 91-407 on Derivatives: Registration*:<sup>4</sup>

we urge the Committee to consider the global nature of the markets when creating regulations for OTC derivatives to ensure that such 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 ... 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

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<sup>4</sup> Letter dated June 17, 2013 from Katherine Darras, General Counsel, Americas, ISDA, page 4.

thresholds that have not been incorporated, in whole or in part, in the Committee's proposal ... 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.

There is a significant risk that an overly prescriptive and complex derivatives registration regime will restrict the ability of Canadian market participants to continue participating in, and remain competitive in, global OTC derivatives markets. As mentioned in our previous letter, ISDA cautions regulators against adopting duplicative or overlapping requirements where sufficient alternatives exist. IOSCO, the Financial Stability Board and other international groups of regulators have noted the value of recognizing prudential supervisory regimes as equivalent to avoid unintended consequences for impacted markets.

### **1. Business Trigger Guidance for the Registration Requirement**

ISDA appreciates the addition of a more robust description of market making activity in the list of business trigger factors used to determine whether an entity is acting as a derivatives dealer. As we have previously commented to the CSA, ISDA prefers that market making be the *only* factor to determine whether an entity is acting as a derivatives dealer. However, if the CSA are not willing to limit the scope of derivatives dealing to market making, in the alternative we continue to recommend that the proposed definitions of derivatives dealer and derivatives adviser be revised to more precisely and clearly articulate whether the activities of a person or company bring them into the scope of these definitions.

In particular, the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" is problematic and difficult or impossible to apply in practice, particularly for buy-side institutions. Frequent derivatives *trading* activity, in the absence of the other business purpose factors, should not constitute dealing activities. For example, large buy-side institutions may engage in various types of OTC derivatives transactions with repetition, regularity or continuity. Examples include the hedging of foreign currencies or the frequent trading of OTC equity derivatives. These transactions are not dealing activity and may not squarely fit within the registration exemption for end users in Section 49 of the Proposed Instrument. We also note that this factor is not included in the similar list of factors to identify a derivatives dealer for trade reporting purposes in the companion policy to MI 96-101 *Trade Repositories and Derivatives Data Reporting*. We see no reason why this factor could be relevant to identify a derivatives dealer for business conduct and registration but not trade reporting. We therefore recommend that the CSA remove from the CP the factor of "directly or indirectly carrying on the activity with repetition, regularity or continuity" as a business trigger or, in the alternative, modify the factor as "directly or indirectly carrying on *market-making* activity with repetition, regularity or continuity".

## 2. Dealer Registration Exemptions

ISDA is generally supportive of the proposed dealer registration exemptions included in the Proposed Registration Rule. We offer the specific comments below and in Schedule A.

### (a) *Trades with a Canadian derivatives dealer*

ISDA has significant concerns that, unlike the securities dealing exemption in Section 8.5 of NI 31-103, there is no registration exemption for derivatives transactions conducted with a Canadian derivatives dealer (for purposes of this section, either a registered derivatives dealer or a regulated financial institution exempt from registration under Section 35.1 of the *Securities Act* (Ontario)). The registration exemption in Section 8.5 of NI 31-103 serves an important function in Canadian securities markets by supporting robust trading and liquidity within Canada and cross-border by enabling unregistered firms, including foreign dealers, to trade securities with Canadian registered investment dealers without the unregistered firm being subject to a Canadian registration requirement. Under the Proposed Registration Rule, however, a trade between an unregistered firm and a Canadian derivatives dealer could potentially subject the unregistered firm to registration or the need to perfect a registration exemption, or at minimum the need to conduct an analysis of whether registration is required. This may cause significant harm to liquidity in Canadian derivatives markets without any corresponding benefit of protection to Canadian investors or market participants. So long as one party is a Canadian derivatives dealer it serves no purpose for both counterparties to be registered in a derivatives trade. ISDA therefore proposes that an exemption for derivatives transactions conducted with a Canadian derivatives dealer be included in the Proposed Registration Rule and the Proposed Business Conduct Rule.

### (b) *Registration exemptions for foreign derivatives dealers*

ISDA supports the provisions in the Proposed Registration Rule which would allow substituted compliance for certain foreign derivatives dealers.<sup>5</sup> However, we note that the Proposed Registration Rule deviates from the registration requirements of foreign dealers in NI 31-103, in that foreign derivatives dealers that will seek to rely on the registration exemption in Section 52 of the Proposed Instrument must be regulated under prescribed laws of a specified list of foreign jurisdictions (both the prescribed laws and the foreign jurisdictions to be identified in an Appendix to the rule not yet published). In contrast, under NI 31-103, a foreign dealer may rely upon the international dealer exemption in Section 8.18 of that instrument so long as it is registered in a category of registration in its home jurisdiction “that permits it to carry on the activities in that jurisdiction that registration as a dealer would permit it to carry on in the local (Canadian) jurisdiction.” ISDA proposes that substituted compliance be an exemption that is available in the

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<sup>5</sup> It is also noted, however, that ISDA is not aware of any evidence that the current model of derivatives dealer registration exemptions employed by most provinces of Canada, which are not conditioned on substituted compliance, is inadequate. ISDA would be supportive of maintaining the status quo of derivatives dealer registration exemptions premised solely on the derivatives parties being EDPs.

Proposed Registration Rule for **all** derivatives dealers that are appropriately registered, exempt from registration, or otherwise not required to be registered in *any* foreign jurisdiction, subject to reasonable limitations. One such limitation, for example, could be that the foreign jurisdiction is an ordinary member of IOSCO.

For greater certainty, if a bank or other entity is operating under a dealer exemption, or is not required to be registered, in its home jurisdiction, the same entity should not be required to register under Canadian derivatives rules for conducting the same activity in Canada. Introducing a carve out that would apply when a bank or other entity is operating under a dealer exemption in another jurisdiction is consistent with the approach towards foreign adviser registration exemption under Section 8.26(4)(b) of NI 31-103, and ISDA is not aware of any compelling reason why this should not apply in the context of a dealer. Further, as we noted in the Proposed Business Conduct Rule Comment Letter, ISDA also requests that the CSA clarify the foregoing carve out for foreign derivatives dealers (and derivatives advisers) will extend to Canadian branches of foreign dealers (and advisers) that are registered or exempt from registration in their home jurisdictions.

(i) Should the CSA keep the approach to substituted compliance for foreign dealers that is currently taken in the Proposed Registration Rule, then it is essential that the CSA publish for public comment the list of available substituted compliance jurisdictions and laws, along with re-publishing the Proposed Instrument and any applicable revisions in advance of finalizing both the Proposed Registration Rule and the Proposed Business Conduct Rule.

In the alternative and where the CSA does not agree to what is proposed above, ISDA urges the CSA to provide certainty as to whether the registration requirements under U.S. Dodd-Frank Act rules are considered fully eligible for substituted compliance. For example, a U.S. bank that only engages in spot FX and physically deliverable FX forwards is not required to be registered as a Swap Dealer under the U.S. Dodd-Frank Act because such FX transactions are not regulated as “Swaps” under the of the U.S. Treasury exemption<sup>6</sup>. Under the Proposed Registration Rule, this same entity would be required to register as a dealer for its same physically delivered FX forward activity with Canadian counterparties. ISDA strongly recommends that the CSA consider current and anticipated regulatory reform proposals in other jurisdictions, such as the proposed registration of security-based swap dealers by the U.S. Securities and Exchange Commission, or the CFTC’s request for comments on its proposal to exclude Non-Deliverable Forwards from the U.S. Swap Dealer de-minimis threshold, to provide adequate flexibility for substituted compliance in the Proposed Registration Rule, and to prevent further regulatory market fragmentation. For example, a U.S. firm may be registered as a Swap Dealer but no registration requirement applies to its security-based swap activities. The U.S. firm should be eligible for substituted

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<sup>6</sup> <https://www.treasury.gov/press-center/press-releases/Documents/11-16-2012%20FX%20Swaps%20determination%20pdf.pdf>; 83 Fed. Reg. 27444, 27447 (noting that for CFTC purposes FX swaps and FX forwards do not count towards determining whether a person must register as a Swap Dealer), available at [https://www.cftc.gov/sites/default/files/2018-06/Federalregister06052018\\_0.pdf](https://www.cftc.gov/sites/default/files/2018-06/Federalregister06052018_0.pdf).

compliance for all of its derivative dealing activities, including those that are considered security-based swaps in the U.S. Finally, ISDA recommends that the CSA develop a mechanism to efficiently add new jurisdictions and foreign laws to any list of substituted compliance jurisdictions. It would be contrary to the purpose of Part 10 of the Proposed Registration Rule for a foreign firm to need to apply for discretionary exemptive relief if the firm is based in a jurisdiction with an appropriate derivatives registration regime but that does not appear in the Appendices to the rule.

Notably, the U.S. CFTC has recently signaled its intention to pursue the utilization of a flexible, outcomes-based approach to substituted compliance, and, particularly for swaps execution and cross-border activities of swap dealers, to recommit to deference processes (such as equivalence and substituted compliance) to increase regulatory coordination and reduce market balkanization. In a recent speech, Chairman Giancarlo of the CFTC stated:

“When it comes to swaps reforms that do involve global systemic risk transfer [i.e. business conduct and registration], we must pursue multilateral coordination to achieve high levels of comparability on the basis of comity but not on the basis of what is identical. The alternative is a world in which every regulator asserts global jurisdiction over swaps trading abroad by its home-domiciled institutions. This leads to overlapping, duplicative and possibly conflicting regulations that stymie global economic recovery...It is a path that is essential for the growth of not only U.S. markets, but also those of important global partners, such as Singapore [which has a share of the global derivatives market larger than that of Canada].”<sup>7</sup>

Given the CFTC’s drive to build consensus among the regulatory community in a global, coordinated manner, ISDA strongly supports the CSA taking a broad approach to assessing substituted compliance while prioritizing an avoidance of disruption of cross border trade flows. Rather than granularly mapping of analogous legal provisions across multiple jurisdictions, we support a comprehensive approach whereby any jurisdiction that is a member of IOSCO would be an appropriate substituted compliance regime. From a policy perspective, ISDA’s view is that there is no justification to limiting foreign dealers to registered dealers of only certain IOSCO jurisdictions.

ISDA also wishes to propose a wording change to Section 52(2)(d) of the Proposed Instrument to address the legal restrictions that may apply to some Canadian and non-Canadian firms if asked to provide information to the CSA:

(d) subject to any blocking, privacy or secrecy laws applicable to the person or company, and, where customary, giving preference to the cooperation between home and host country regulatory authority regarding books and records access, the person or company undertakes to the securities regulatory authority to provide the

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<sup>7</sup> Remarks by Chairman J. Christopher Giancarlo at the ISDA Industry and Regulators Forum, Singapore, September 12, 2018

securities regulatory authority with prompt access to its books and records upon request.

We note that the same wording change should apply to Section 59(2)(d) of the Proposed Instrument and any other sections of the Proposed Registration Rule that require that materials be provided to a securities regulatory authority. We further note that access to books and records should be limited to books and records relating to transactions with Canadian counterparties.

(c) *Registration Exemptions for Globally Integrated Firms*

ISDA is concerned that the Proposed Registration Rule may give rise to significant unintended adverse business consequences for derivatives dealers or advisers that operate in a globally integrated fashion. For example, some global financial firms will involve individuals who represent multiple affiliated entities in a single derivatives transaction with a Canadian counterparty. One simple example of this approach is a global derivatives firm that maintains salespeople in a Canadian affiliate to solicit trades, trading personnel in a foreign affiliate to negotiate and price trades and execute confirmations, and a booking entity in a third jurisdiction that acts as the counterparty to trades. Another example of this approach is a global derivatives firm that provides advisory services through one affiliate and provides negotiation and trade execution services through another affiliate. ISDA submits that consideration should be given to either (i) clarifying the registration triggers in the CP or (ii) adding an additional registration exemption in the Proposed Instrument, to avoid unnecessary duplication of registration and compliance obligations across multiple affiliated entities. For example, it would be useful to provide guidance in the CP that a foreign derivatives counterparty to a trade that acts as a booking entity and is not involved in soliciting or negotiating the trade is not in the business of dealing in derivatives in Canada. Another possibility would be the introduction of derivatives dealer and adviser registration exemptions that would be applicable where globally integrated firms involve multiple affiliated entities in a derivatives transaction, which exempts affiliated entities that have an incidental involvement in the transaction, subject to the affiliated entity with ‘primary’ responsibility for the transaction either being registered as a derivatives dealer or derivatives adviser or relying upon a registration exemption.

For example, a Canadian registered adviser (A Co) may advise clients in Canada, but negotiation and execution of derivatives transactions may be the responsibilities of an affiliate (B Co) in the U.S. under an execution services agreement. Under the Proposed Registration Rule, A Co is subject to registration as a derivatives adviser, and B Co is subject to registration as a derivatives dealer due to its facilitation/intermediary activities. However, it could be argued that from the perspective of the “group”, services are simply being split up and it should be sufficient for A Co to be registered as a derivatives adviser, with the dealing activity being viewed as incidental to the advising activity. Correspondingly, where the services to a client are shared between affiliates, it should be sufficient if one of the affiliates is registered as either a derivatives adviser or a derivatives dealer, provided that the exempt affiliate’s activities can be viewed as incidental to the non-exempt entity’s activities.

### **3. Adviser Registration Exemptions**

ISDA is concerned that the proposed exemption for foreign derivatives advisers in Section 59 of the Proposed Instrument will be subject to a condition that the foreign derivatives adviser be registered, licensed or otherwise authorized to give advice in respect of derivatives in its home jurisdiction. While many foreign jurisdictions have developed registration requirements for derivatives dealing, it remains uncommon for foreign jurisdictions to apply a registration requirement to derivatives advising activity. For example, there is no registration category specific to swaps advisers (that do not also advise on certain non-OTC derivatives, such as futures) under the U.S. Dodd-Frank rules. In our view, it is not feasible for the CSA to generate a list of foreign jurisdictions, or laws of foreign jurisdictions, that qualify for substituted compliance from Canadian derivatives adviser rules. ISDA recommends that the better approach would be for the CSA to adopt a foreign derivatives adviser exemption that is similar to the international adviser exemption in Section 8.26 of NI 31-103, in that the exemption would be available to any foreign derivatives adviser registered or operating under an exemption from registration in its home jurisdiction as a derivatives adviser. ISDA recommends that this exemption should also be available to a foreign derivatives adviser that is not required to be registered in connection with its derivatives-related activities in its home jurisdiction, provided that the foreign derivatives adviser is registered or is operating under an exception from registration under the foreign jurisdiction's securities legislation. These alternatives would not be conditioned on substituted compliance with an enumerated list of eligible foreign jurisdictions and laws and takes into account the fact that foreign jurisdictions do not have registration requirements applicable to OTC derivatives-related advising activity. ISDA believes that flexibility is necessary and appropriate to ensure that Canadian end users and investors may continue to access a broad range of expert foreign advice in respect of their derivatives trading activities.

The CSA should also consider the introduction of an exemption from derivatives dealer registration for registered derivatives advisers and their registered advising representatives that is similar to the adviser exemption for registered derivatives dealers and their registered dealing representatives without discretionary authority in Section 58 of the Proposed Instrument. 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) of the Proposed Instrument, 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 exempt from adviser registration) that is similar to the 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 the exemption in Section 8.5.1 of NI 31-103 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 ISDA's view that this condition is not appropriate for the

derivatives market, since derivatives would not typically be transacted “through” a derivatives dealer.

Further, ISDA is concerned that the affiliated entity exemption in Section 60 of the Proposed Instrument requires clarification that Section 60(2) would not disqualify a company that advises an affiliated investment fund whose only investors are other affiliated entities. It is common for an entity within a corporate group to centralize its expertise and advise affiliated entities within that corporate group, including wholly-owned investment funds, on derivatives hedging and investment strategies. A company that advises an internal investment fund that is wholly-owned by affiliated entities and does not permit third party investors cannot logically be viewed as “advising others” since there is no connection to an outside party and a company cannot logically advise itself. For the same reasons, the company cannot logically be viewed as holding itself out to others since there are no outside parties or investors and the company cannot hold it out to itself.

#### **4. Delivery of Quarterly Financial Statements and Working Capital Calculations**

Section 36 of the Proposed Instrument requires all registered derivatives firms to file quarterly financial information. Section 37(2) of the Proposed Instrument also requires registered derivatives dealers to file quarterly working capital calculations. These quarterly filing requirements are substantial and inconsistent with current requirements for securities dealers (other than IIROC dealers) and advisers, who are required to file financial information and working capital calculations annually, not quarterly. The CSA has not explained why it is necessary for a derivatives firm to comply with enhanced financial reporting obligations that do not apply to non-IIROC regulated securities dealers and advisers that carry on business in Canada. We request that the CSA provide clarification that entities can deliver consolidated financials to meet the quarterly financial information requirement pursuant to section 36(2) of the Proposed Instrument.

#### **5. Confirmation of material terms**

Section 40 of the Proposed Instrument requires a registered derivatives firm to confirm the material terms of each derivative transacted with or for the derivatives party as soon as feasible after completion of the transaction. The CP further notes that where the derivatives party is an individual or is not an EDP, the registered derivatives firm complies with the requirements of subsection 40(1) by delivering the written confirmation that is required to be sent by a derivatives dealer under section 29 of the Proposed Business Conduct Rule (which is Section 27 in the revised version of the Proposed Business Conduct Rule). There is no Section 40(1), and Section 29 of Proposed Business Conduct Rule referenced under the CP should be changed to Section 27 under the revised version of the Proposed Business Conduct Rule.

ISDA also seeks clarification over what is required in order to comply with Section 40 when the derivatives party is an EDP. Presumably, it is sufficient for a registered derivatives firm to comply with Section 27 of the Proposed Business Conduct Rule but this is unclear. Further, we request that the CP clarify that Section 40 of the Proposed

Instrument only applies to a derivatives dealer, which would be consistent with Section 27 of the Proposed Business Conduct Rule.

## **6. Determining the Value of a Derivative**

Section 41 of the Proposed Instrument requires registered derivatives firms to enter into a written agreement with each derivatives party with which it enters into a transaction to establish a process for determining the value of the derivative. However, the Proposed Instrument doesn't specify whether "value" means mark-to-market or close-out amount. The requirement to enter into a written agreement that sets out the process for determining the value of a derivative in a written agreement is not feasible for foreign exchange trades which may not be conducted pursuant to an industry standard agreement such as an ISDA Master Agreement. The requirement to enter into a written agreement to determine value would be a significant disruption to FX trading with non-U.S. counterparties. It is not possible or feasible to force global counterparties to adhere to a Canadian specific protocol. ISDA therefore submits that the Section 41 requirement should either be eliminated or modified with reasonable guidance on acceptable practices for determining the value of a derivative. For example, instead of specifically requiring a written agreement to determine value, Section 41 could be modified to give guidance on how a dealer may determine the value of a derivative and provide appropriate disclosure over valuation assumptions and methodologies to its counterparty.

If the CSA is not willing to eliminate the requirement under Section 41, ISDA requests that the CSA clarify that, where the Section states that "a registered derivatives firm must, in relation to each transaction with a derivatives party, enter into a written agreement with the derivatives party that establishes a process for determining the value of a derivative", this is in reference to a written agreement that must be in place between a registered dealer and its counterparties, rather than an agreement that must be in place between and adviser and the adviser's derivatives party. It would also be helpful if Section 41 was revised to clarify whether this Section applies to a registered derivatives adviser. Further, the CP should expressly indicate that the entering into of a standard form (boilerplate) ISDA Master Agreement will meet the requirements of this Section.

## **7. Reporting Unresolved Disputes, Portfolio Reconciliation and Portfolio Compression**

Section 42 of the Proposed Instrument requires registered derivatives firms to enter into an agreement with each derivatives party it enters into a derivatives transaction with that provides for a dispute resolution process. The registered derivatives firm must also report disputes that have not been resolved "within a reasonable period of time" to its board of directors and, if unresolved within 30 days of reporting the dispute to the board, report the dispute to the regulator. ISDA submits that (i) the reporting should be permitted to be made to an appropriate management committee or sub-committee; (ii) that the 30 day period within which disputes must be resolved after reporting to the board (where, if not resolved, such disputes must be reported to the regulator) is too short and should be extended; and (iii) that an unresolved dispute should only need to be reported to the regulator by a

registered derivatives dealer and only if such dispute would reasonably be expected to have a material adverse effect on the business and operations of the registered derivatives dealer (when a counterparty to a transaction). Further, the CP should include guidance that materiality should be determined based on the business and operations of the derivatives firm as a whole. ISDA also proposes that there should not be any obligation to report a dispute to a Canadian regulator when the derivatives transaction involving a registered derivatives firm does not involve a Canadian counterparty.

Further, the requirement under Subsection 44(4) of the Proposed Instrument for a registered derivatives firm to enter into a written agreement with each derivatives party that describes the terms of the portfolio reconciliation required to be conducted under Subsection 44(1) is also not feasible for foreign exchange trades which may not be conducted under an industry standard agreement such as the ISDA Master Agreement and Credit Support Annex. Also, as the standard form Credit Support Annex currently used by Canadian market participants do not satisfy the requirements of Subsection 44(4), this Subsection will also require market participants to amend their current Credit Support Annexes in order to remain compliant.

Ultimately, ISDA observes that Section 42 (and Section 44) of the Proposed Instrument will also necessitate a Canadian-specific ISDA protocol similar to the ISDA 2013 EMIR Portfolio Reconciliation, Dispute Resolution and Disclosure Protocol introduced in the European Union post EMIR. Our concern is that, unlike the E.U., foreign dealers will not be willing to adhere to a Canadian specific protocol and will simply trade with other market participants instead. No other jurisdiction with a derivatives market of a comparable size (e.g. Australia) has an ISDA protocol. The CSA should expressly indicate that the entering into of a standard form (boilerplate) of the Credit Support Annex to ISDA Master Agreement will meet the requirements of Section 42(1). Also, the words “as soon as possible” in Section 42(1)(b) should be changed to “within a reasonable period of time”, to be consistent with Sections 42(2) and 42(3) and to more realistically take into account actual market practice. Lastly, ISDA requests that the word “material” be inserted before the word “dispute” in Sections 42(3) and 42(4).

In addition to the above, ISDA also requests clarification by the CSA that Sections 41 and 42 of the Proposed Instrument do not apply to a derivatives firm that is an adviser that acts for or on behalf of a derivatives party. The use of the words “or for” in Section 40, but not in Sections 41 or 42, suggests that a derivatives firm that is an adviser does not have the responsibilities (that more clearly would apply to a derivatives dealer) that are set out under these two Sections. We note that Sections 41 and 42 appear to dovetail with Section 33 of the Proposed Business Conduct Rule, and the CP to the Proposed Business Conduct Rule suggests that the relevant agreement is between two counterparties to a transaction. Sections 41 and 42 should therefore be revised to clarify the responsibilities of a derivatives adviser when acting for or on behalf of its client.

ISDA also notes that Sections 44 and 45 of the Proposed Instrument should only apply to a derivatives dealer when it is a counterparty, and not to a derivatives adviser, since the adviser will never be a “counterparty” for which portfolio reconciliation or portfolio

compression exercises are applicable. More specifically, bilateral and multilateral portfolio compression exercises referenced under Subsections 45(1)(c) and 45(1)(d) of the Proposed Instrument would only be undertaken between derivatives parties that are derivatives dealers, and not between derivatives advisers and their clients. Accordingly, ISDA requests that the CSA change that all references in Sections 44 and 45 of the Proposed Instrument to “a derivatives firm” to “a derivatives dealer”, and all references to “a registered derivatives firm” to a “registered derivatives dealer”. Alternatively, ISDA requests the CSA to provide clarification as how Sections 44 and 45 of the Proposed Instrument applies to registered derivatives advisers.

#### **8. Interplay of Proposed Registration Rule with Trade Reporting Requirements**

ISDA is concerned about the interplay between the Proposed Registration Rule and the trade reporting rules in Ontario, Quebec and Manitoba (together, “91-507”), which differ from the trade reporting rules in other jurisdictions of Canada (“96-101”). Under 91-507, the definition of “local counterparty” includes a registered derivatives dealer. As a result, all transactions with a registered derivatives dealer must be reported, even if the counterparty to the registered derivatives dealer is not in Canada. Alternatively, under 96-101, while the definition of “local counterparty” includes a derivatives dealer (whether registered or not), Section 42 of 96-101 provides an exclusion from reporting for derivatives transactions between a non-resident derivatives dealer and a non-local counterparty.

The practical consequence of the difference between 91-507 and 96-101 reporting requirements is that, upon the registration requirements of the Proposed Registration Rule taking effect, certain domestic and any non-resident registered derivatives dealers that are not local counterparties under paragraph (a) of the definition of local counterparty in 91-507 will be required to report *global* trading activity in Ontario, Quebec and Manitoba, but report only *local* trading activity in all remaining provinces. With respect, this distinction is untenable. In our view, there is no reasonable basis for registered derivatives dealers to report global trading activity to securities regulators and regulatory authorities in Ontario, Manitoba and Quebec. To do so would require all reporting parties to do a new outreach to all local counterparties in the three provinces with an updated Canadian trade reporting counterparty representation letter. ISDA therefore requests that the securities regulators and regulatory authorities in Ontario, Manitoba and Quebec to amend their respective 91-507 trade reporting rules to include the same reporting exclusion found in Section 42 of 96-101 for the purposes of harmonization and efficiency of capital markets.

#### **9. Capital Requirements and Other Information Contained in Appendices**

We request that the CSA publish for public comment a proposed framework for capital requirements (Appendix C of the Proposed Instrument) sufficiently well in advance of the Proposed Registration Rule taking effect. It is essential that market participants have an opportunity to consider the Proposed Registration Rule and the Proposed Business Conduct Rule with all relevant information available, including all information that will ultimately populate the appendices and schedules of the two rules.

## **10. Dealing and advising with affiliates and non-affiliates**

Sections 53 and 60 of the Proposed Instrument set out exemptions from the requirement to register when a person or company is required to register as a derivatives dealer or adviser only as a result of dealing with or advising an affiliated entity. Where a derivatives firm is transacting with or advising affiliates in addition to non-affiliates, the exemptions in Sections 53 and 60 will not be available, and the derivatives firm must register as derivatives dealer or adviser. However, it is unclear whether the derivatives firm must comply with all provisions of the Proposed Registration Rule in respect of the specific relationship(s) between the derivatives firm and its affiliates. ISDA requests that the CSA provide clarification on this matter in the scope provision (Section 2) of the CP.

## **11. Effective date and scope of Proposed Registration Rule**

The requirements in the Proposed Registration Rule and the Proposed Business Conduct Rule should come into effect concurrently, with sufficient time allowed to implement appropriate policies and procedures, train relevant personnel, receive any required representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation.

Multiple members of ISDA have also emphasised the importance of CSA publishing the entire Proposed Registration Rule including the proposed appendices for comment prior to its finalization. Without sufficient knowledge over the scope of substituted compliance, it is impossible for market participants to assess the impact of the Proposed Registration Rule.

We also request that the CSA clarify that the requirements in the Proposed Registration Rule will not apply to unexpired derivatives that were entered into before the effective date of the Proposed Registration Rule. The Proposed Registration Rule currently does not contemplate grandfathering of derivatives that are entered into before the effective date of the Proposed Registration Rule. In our view, all pre-effective date transactions (regardless of their remaining term) should be grandfathered. That grandfathering should apply even if pre-effective date transactions are subsequently amended after the effective date of any final registration rule. Although ISDA notes that the requested relief may only be effective until such time as derivatives dealing or derivatives advising occurs in respect of transactions entered into after the Proposed Registration Rule comes into force, the requested relief will be very valuable to members of ISDA, some of which have run-off relationships with dealer counterparties with which there is no intention of transacting further.

\* \* \* \*

ISDA and its members would like to reiterate our appreciation to the CSA for the opportunity to provide feedback on the Proposed Registration Rule. We are happy to discuss our responses and to provide any additional information that may be helpful.

Thank you for your consideration of these important issues to market participants. Please contact the undersigned if you have any questions or concerns.

Yours very truly,



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Name: Katherine Darras  
Title: General Counsel

## Schedule A:

### Specific requests for comment from the CSA

#### 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.*

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

*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.*

*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?*

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

The calculation of notional amounts for purposes of the derivatives dealer registration exemptions in Sections 50 and 51 of the Proposed Instrument requires a firm to count the aggregate month-end gross notional amount under outstanding derivatives that involve the firm and its affiliates (but excluding derivatives transactions between affiliated entities). This calculation should exclude notional amounts of affiliates that are:

- (i) registered, licensed or otherwise authorised to conduct derivatives activities, or

- (ii) exempt from registration.

under the laws of Canada or the laws of a recognized foreign jurisdiction.

Alternatively, the calculation of notional amount should include those derivatives such an affiliate has with Canadian counterparties. Accordingly, for all other foreign jurisdictions only derivatives between the affiliates and Canadian legal entities should be included in the calculation of notional amounts pursuant to Section 50 and 51 of the Proposed Instrument.

Further, some ISDA members prefer the CDE guidance over the Regulatory Notional Amount methodology as set out in Column 2 of Annex I. The CDE Guidance methodology is consistent with the current methodology used for the members' regulatory and financial reporting. The Regulatory Notional Amount methodology would require significant implementation efforts as data required for that methodology is currently not readily available in the members' source systems.

## **2. Definition of “affiliated entity”**

*The Instrument defines “affiliated entity” on the basis of “control”, and sets out certain tests for “control”. In the context of other rules relating to OTC derivatives, the CSA is 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.*

As ISDA has noted in previous comment letters until such time as the CSA addresses the definition of affiliate more broadly, ISDA believes it is important that the Proposed Registration Rule not create additional uncertainty as to how the term affiliate is to be applied. It would be problematic if a different definition of affiliate were applied in different derivatives rules such as registration, trade reporting or mandatory clearing rules without a comprehensive consultation. We request that the CSA make efforts to avoid the potential for additional uncertainty by avoiding a change to the definition of “affiliate” specifically for the Proposed Registration Rule. ISDA supports a separate consultation to understand and improve the definition of affiliate more generally throughout Canadian OTC derivatives rules.

## **3. 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.*

ISDA appreciates that the CSA has included a category of “commercial hedgers” in paragraph (n) of the definition of EDP. We expect that the inclusion of a commercial hedger category will help mitigate the risk that Canadian commercial hedgers will be unduly burdened by the introduction

of the Proposed Registration Rule and Proposed Business Conduct Rule. However, ISDA continues to have other concerns with the EDP definition.

While we acknowledge that the CSA has taken steps to ensure that commercial hedgers are subject to a lower financial threshold to qualify as eligible derivatives parties when compared to other, non-individual, persons or companies, we have concerns with the high threshold for a commercial hedger category of EDP at paragraph (n). Currently there is no hedger threshold in most of Canada, and a much lower Eligible Contract Participant (“**ECP**”) threshold in the U.S. Members of ISDA urge the CSA to delete the financial threshold for commercial hedgers and, failing that, align the EDP and ECP definitions.

Respectfully, sophisticated entities with less than \$10 million in net assets should be eligible to hedge using derivatives as EDPs. At a threshold of \$10 million in net assets, ISDA expects that many mid-market entities will not be able to satisfy the asset threshold to qualify as EDPs and would therefore be unfairly prevented from participating in certain derivatives transactions should derivatives dealers opt to only trade with EDPs. Absent a clear policy justification for excluding mid-market entities from access to OTC derivatives transactions as qualified EDPs, we request that either there be no minimum net asset threshold or a lower net asset threshold of \$1 million in net assets for these smaller businesses. ISDA believes that this will result in healthy competition in the Canadian markets for commercial hedgers, while still satisfying the CSAs policy objectives. Further, many subsidiaries of large multinational corporations, including special purpose entities, may not satisfy the \$10 million net asset requirement, which is inconsistent with the ECP requirements. Such subsidiaries are centrally managed by corporate treasury and are generally using derivatives to hedge or mitigate commercial risks. Many such special purpose entities are also intentionally structured to minimize net assets. A lower net asset threshold would help to mitigate these concerns.

With respect to paragraphs (m), (n) and (o) of the definition specifically, as noted in past comments to the CSA, the requirement for written representations regarding requisite knowledge and experience requirement is unnecessary and may have the unintended effect of disadvantaging sophisticated derivatives parties that currently benefit from participation in the derivatives market. We believe that financial thresholds, which have been widely adopted as the objective standard to assess sophistication in Canadian securities regulation and U.S. securities and derivatives regulation, are appropriate and sufficient to identify derivatives parties who are not in need of extra protections. Whether individuals or not, persons who have sufficient financial resources to purchase professional advice (where necessary) or are otherwise financially sophisticated parties can independently assess their risks and make their own judgments regarding their derivatives transactions.

ISDA also remains concerned that, in addition to obtaining written knowledge representations from a derivatives party, the CP would require firms to assess the reasonableness of relying on a derivative party’s written representations regarding their knowledge and experience. As we have previously expressed to the CSA, this creates unnecessary ambiguity around the determination of a derivatives party’s EDP status. If the requirement to obtain such representations is retained by the CSA in the final definition of EDP in both the Proposed Registration Rule and Proposed

Business Conduct Rule, derivatives firms should be able to rely on those representations absent having any basis or grounds to believe the representations are false. It is unduly burdensome to impose an affirmative obligation on dealers and advisers to assess the reasonableness of representations from counterparties who satisfy the financial thresholds in paragraphs (m), (n) or (o) of the EDP definition.

To reiterate, requiring written representations regarding requisite knowledge and experience from derivatives parties and requiring a subjective assessment of those written representations by derivatives firms will impose a significant burden on derivatives firms without any meaningful benefit to derivatives parties. The additional cost and compliance burden may seem minor in isolation, but when combined with derivatives trade reporting requirements, mandatory clearing requirements, margin requirements for uncleared derivatives trades and requirements that may apply under securities law, the cumulative impact on derivatives firms to obtain another written representation from derivatives parties and assess the reasonableness of that representation is unwarranted and onerous. If the CSA has an informed concern, based on an objective assessment of current Canadian derivatives markets, that there is a meaningful population of Canadian persons who meet the financial thresholds in paragraphs (m), (n) or (o) but do not have the requisite knowledge and experience to transact in derivatives, that concern should be specifically explained in future rule proposals subject to public comment so that derivatives firms can consider and respond with proposed solutions to mitigate or address that concern.

ISDA also remains concerned that the EDP definition mostly duplicates other established Canadian definitions, such as “permitted client” in NI 31-103. As ISDA has observed in past comments to the CSA, notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of EDP should include all the persons that qualify as “permitted clients” under NI 31-103. We have previously indicated that the derivatives industry will face an enormous compliance burden if existing disclosures and representations by clients regarding their “permitted client” status cannot be leveraged to determine EDP status under the Proposed Registration Rule and Proposed Business Conduct Rule. We do not believe that this compliance burden is warranted. If an entity is eligible to participate in the exempt securities market, it stands to reason that it does not need the full set of protections contemplated under the Proposed Business Conduct Rule for non-EDPs. It should be re-emphasized that, given that derivatives dealers typically have an ongoing credit relationship with their derivatives counterparties, derivatives dealers indirectly address investor protection concerns as dealers have an extra incentive to appropriately assess and manage risk with their derivatives counterparties.

We have previously observed that, given the existing definitions of “accredited investor” for prospectus disclosures and “permitted client” under NI 31-103, a different definition for EDPs would result in market participants trading prospectus exempt securities and derivatives having to analyze and give representations with respect to three separate definitions. Also, for derivatives firms that are regulated in other jurisdictions, it is commonly the case that the derivatives firm must confirm whether the derivatives party is an “eligible contract participant” as defined in the CEA.

Participants in the global derivatives markets have incurred significant costs in recent years overhauling their onboarding procedures and reference data systems to classify counterparties under the many different rule sets and related definitions implemented as part of the G20 reform agenda (including, most recently, in connection with new rules for margin for uncleared derivatives). Unless dealers and advisers may rely on existing representations and disclosures regarding their clients' "permitted client" and "eligible contract participant" status, a large-scale outreach effort will be required to determine the EDP status of all counterparties to comply with the Proposed Registration Rule. Respectfully, no compelling policy reason has been identified which would justify imposing such a significant compliance burden on the derivatives markets in Canada. We therefore request that additional paragraphs be added to the definition of EDP to deem any derivatives party that is (i) a "permitted client" as defined in NI 31-103 or (ii) an "eligible contract participant" as defined in the CEA to also be an EDP.

**4. 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.*

*The CSA understands 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, the CSA 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 the CSA 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?*

Firms that are registered or exempt from registration as an adviser under securities legislation or commodity futures legislation, and that may provide limited advice in relation to derivatives or strategies involving derivatives, or may manage an account for a client and make trading decisions on limited occasions for the client in relation to derivatives or strategies involving derivatives, should not be subject to a derivative registration requirement where the performance of these activities in relation to derivatives is limited in nature so that it could reasonably be considered to be incidental to the performance of their activities as a registered adviser for securities. Advising on derivatives on an incidental basis, for example giving advice in respect of a hedging transaction entered into in relation to a securities trade, should not trigger the application of either the Proposed Registration Rule or the Proposed Business Conduct Rule, so long as the firm is appropriately registered or relies on a registration exemption under applicable Canadian securities law.

ISDA believes that there should be a specific exemption for incidental advice in respect of derivatives. CP guidance on the derivatives adviser registration trigger is insufficient, especially given the broad registration triggers such as “recommending a derivatives trading strategy”. An exemption would provide greater clarity and comfort for firms that provide incidental advice in respect of derivatives and would be consistent with similar exemptions in commodity futures legislation.

Another example of activities that are limited in nature and that could reasonably be considered incidental to the performance of activities as a registered adviser for securities is where the derivatives-related advice, whether for hedging or non-hedging purposes, would not be reasonably considered by the derivatives party to be core to the overall investment activity or the primary investment activity that is employed for the derivatives party. This may be evidenced by the description of the derivatives-related investment activity that is employed by the registered securities adviser for a derivatives party relative to the overall investment activity 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.

Also, the test for what is “incidental” should not hinge on the frequency of transacting. As stated on the second page above, large buy-side institutions may engage in various types of OTC derivatives transactions with repetition, regularity or continuity. Currency hedging is often done on a very frequent basis but this activity may still be considered incidental.

It would be appropriate for the Proposed Instrument to also include express exemptions for a registered adviser under securities or commodity futures legislation in either of the following circumstances:

- Where (i) the registered adviser has incorporated and applies risk management-related policies and procedures that substantially comply on an outcomes basis with Section 39 of the Proposed Instrument, if and to the extent that the CSA requires a derivatives adviser acting for its clients to comply with that Section (please see ISDA’s response to Question 10 below), (ii) a “derivatives chief risk officer” is designated by the registered adviser and the derivatives chief risk officer complies on an outcomes basis with Section 29 of the Proposed Instrument, and (iii) the initial and ongoing proficiency requirements that are set out in Section 18(1) of the Proposed Instrument are complied with.
- 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 Instrument) in relation to the derivatives that it transacts, and such derivatives party is an “eligible derivatives party”. 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 rule by the registered adviser will not add any necessary protections to market participants.

*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 the CSA 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?*

See response to 4(a) above.

#### **5. IIROC membership for certain derivatives dealers**

*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?*

ISDA is not aware of any compelling policy rationale for requiring a derivatives dealer to become an IIROC dealer member in order to transact with an individual that is not an EDP. For example, it is common for Canadian financial institutions to provide currency hedges to individuals who are purchasing property in another country. Such practice, which is not for an investment purpose, should not require regulatory oversight by IIROC. Further, it should be observed that only Canadian domiciled firms are eligible to become members of IIROC. Accordingly, Section 9 would prohibit any foreign firm from transacting with an individual that is not an EDP. ISDA believes that this prohibition is unwarranted in light of the many compliance obligations imposed on derivatives firms under the Proposed Registration Rule and the Proposed Business Conduct Rule.

ISDA is also concerned that, as drafted, the proposed prohibition on a registered derivatives dealer transacting with a derivatives party who is individual is not limited to derivatives parties in Canada. The Proposed Registration Rule should not prohibit a registered derivatives dealer from transacting with a derivatives party who is an individual but who is not a resident of Canada. For example, some financial institutions in Canada trade OTC derivatives with non-Canadian individuals through branches in foreign jurisdictions. These individuals must satisfy applicable thresholds under foreign laws. To require those financial institutions to trade through a Canadian IIROC broker dealer (and presumably licence that broker dealer entity in the foreign jurisdiction) is not feasible and does not appear to be supported by any reasonable policy rationale. Such a prohibition would be a significant overreach and beyond the scope of authority of the CSA.

#### **6. 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?*

While ISDA welcomes the exemptions from individual registration for trading only with EDPs, we are concerned that the exemption does not apply if acting as an adviser to a managed account for an EDP. The reasons for this distinct treatment are not articulated in the Proposed Registration Rule. An EDP that chooses to retain a derivatives firm to provide managed account services in respect of derivatives does not, as a matter of investor protection, require individual representatives of the derivatives firm to be registered. Respectfully, an EDP that engages a derivatives firm for managed account services can conduct their own assessment of the experience and expertise exhibited by individual representatives of a derivatives adviser. Further, as indicated in the CSA's introduction to the Proposed Instrument, an EDP may reasonably be considered to be sophisticated or have sufficient financial resources to protect itself through contractual negotiation. In the case of a managed account, the EDP will have entered into a negotiated investment management agreement (or similar) and will also benefit from the responsibilities owed to it by the registered adviser as a fiduciary. In addition, the individuals will still have to meet the proficiency requirements that are set out in Section 18(1) of the Proposed Instrument. Lastly, the deletion of the condition that the individual must not act as an adviser to a managed account of any derivatives party would be consistent with the CSAs' decision to see past the managed account structure and delete Section 7(3) from Proposed Business Conduct Rule.

More generally, registration of dealing representatives and advising representatives is not appropriate for the derivatives markets. It is inconsistent with international approaches to regulating derivatives firms to require a firm's representatives to be registered. A better approach, consistent with IOSCO recommendations, would be a requirement for derivatives firms to disclose to clients and counterparties the names of senior managers and those acting on its behalf.

#### **7. 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?*

The CSA should not set proficiency requirements for individual representatives of derivatives dealers and derivatives advisers, and individuals should be exempt from registration without being subject to the conditions set out in Sections 16(3) and 16(4) of the Proposed Instrument. Setting proficiency requirements is inconsistent with international approaches to regulating derivatives dealers, derivatives advisers and their representatives. In a competitive and highly regulated market environment, a derivatives firm must employ individuals with diverse skills and experience to deal with counterparties and advise clients. These individuals usually possess years of experience or post-graduate degrees (or both), may be Chartered Financial Analysts and/or may be accountants or lawyers. It should be the responsibility of the derivatives firms, including the firm's ultimate designated person, chief compliance officer, chief risk officer and supervisors, to ensure that the firm's representatives have sufficient knowledge, skill and experience to trade or advise in derivatives. Respectfully, it will be difficult for Canadian securities regulators and the Canadian Securities Institute to have an informed perspective on what proficiencies the representatives of a derivatives firm should individually and collectively possess. The onus should be on derivatives firms to ensure that their representatives have appropriate proficiency for their

specific responsibilities, taking into account the types of derivatives traded and the attributes of a firm's clients or counterparties. The CSA should instead require registered firms to act reasonably in setting proficiency requirements for its representatives. If conditions in respect of proficiency are to apply, ISDA submits that Section 18(1) of the Proposed Instrument would be sufficient to protect market participants.

Also, ISDA submits that the individual at a derivatives firm that assumes the role of the derivatives Chief Risk Officer and any person that is currently authorized under securities legislation to act as an ultimate designed person, chief compliance officer, dealing representative or advising representative should be grandfathered from the new proficiency requirements, similar to the approach that was taken for previously registered individuals with the introduction of NI 31-103 in 2009. For example, for firms that are registered under Canadian securities legislation and have a registered Chief Compliance Officer, and if applicable, a Chief Risk Officer, who will assume the role of derivatives chief compliance officer and derivatives chief risk officer, as applicable, ISDA proposes the grandfathering of such individuals from any proficiency requirements contemplated in the Proposed Registration Rule.

Should the CSA choose to move forward with prescribing specific requirements, ISDA requests that there be, at minimum, a three-year transition period to enable individuals to study for and complete the prescribed exams.

In addition to the above, ISDA submits that Section 18 should be amended as follows:

*Proficiency requirements for the derivatives chief compliance officer*

- Section 18(2)(a)(iii)(B) – Please insert the words “at a registered securities firm” before the words “,a derivatives dealer”. ISDA sees no justifiable reason for including experience gained while working at a registered firm under Section 18(2)(a)(iii)(A) but not including such experience under Section 18(2)(a)(iii)(B).
- Section 18(2)(b)(i) – Please delete the words “specified in column 1 of Appendix B” after the words “adviser in a foreign jurisdiction”. We see no justifiable reason for this requirement and note that it is not included in Section 18(2)(a)(iii)(A).

*Proficiency requirements for the derivatives chief risk officer*

- Section 18(2)(b)(ii) and 18(3)(c)(ii) – Please insert the words “or an affiliate” after the words “at a Canadian financial institution”.
- Section 18(3)(a) – Please insert the word “or” after “CFA Charter,” for greater certainty.
- Section 18(3)(a) – Some ISDA members employ staff who have completed a course designation known as “Financial Risk Manager” (FRM) that is hosted by the Global Organization of Risk Professionals. This course has a very significant derivatives component and we would ask the CSA to consider adding the FRM designation to Section 18(3)(a) as an additional way to obtain proficiency.

- Section 18(3)(b)(i) – Please delete the words “specified in column 1 of Appendix B” after the words “adviser in a foreign jurisdiction”.
- Section 18(3)(c)(i) – Please insert the words “at a registered securities firm” before the words “,a derivatives dealer”.

#### **8. 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 noncompliance creates a risk of material harm to any derivatives party. Is this requirement appropriate?*

ISDA is generally supportive of requirements that reports of non-compliance with derivatives laws, the Proposed Instrument and a firm’s risk management policies be prepared and delivered to a derivatives firm’s board of directors (or equivalent) where non-compliance creates a risk of material harm to a derivatives party or the capital markets, or if the non-compliance is part of a pattern of non-compliance. This practice is emblematic of good governance and creating a culture of compliance with derivatives laws. However, ISDA does not believe that the Proposed Registration Rule should prescribe that such report be delivered by a firm’s ultimate designated person. Other individuals, such as a firm’s chief compliance officer or chief risk officer, should be able to perform this task, if deemed appropriate by the derivatives firm. Some ISDA members have noted that, as the Proposed Registration Rule is currently drafted, too many persons are reporting to the board. ISDA members request for more flexibility in respect of who performs such reporting duties and believe that the derivative chief compliance officer is a more appropriate candidate. Also, ISDA believes that the requirement to report on compliance to a derivatives firm’s board of directors should more closely resemble the requirements applicable to securities registrants under Part 5 of NI 31-103, as this would reduce the cost and compliance burden associated with compliance with the Proposed Instrument. For example, under Part 5 of NI 31-103 there is no requirement for an ultimate designated person to report to a registered firm’s board of directors, and the ultimate designated person’s responsibilities are limited to supervising the activities of the firm to ensure compliance with securities legislation and promoting compliance with securities legislation. Also, Part 5 of NI 31-103 provides that a chief compliance officer must report to a registered firm’s board of directors on an annual basis with an assessment of the firm’s compliance with securities legislation. ISDA is not aware of any rationale for the internal reporting requirements for derivatives firms to be introduced at a much higher standard than the long-standing reporting requirements for registered securities firms. In the absence of any compelling rationale, ISDA respectfully requests that the CSA not deviate from longstanding conventions relating to reporting responsibilities in introducing a new derivatives registration regime. A better approach, which is already reflected in Section 30 of the Proposed Instrument, is to require that a registered derivatives firm must ensure that its ultimate designated person, chief compliance officer and chief risk officer have reasonable access to the firm’s board of directors (or equivalent), if and when required.

Lastly, ISDA is also of the view that the requirement for the derivatives ultimate designated person to report to the board in the circumstances set out in Section 27(3)(c) of the Proposed Instrument duplicates the requirement for the senior derivatives manager (or the derivatives chief compliance officer if delegated) to report to the board in the circumstances set out in Section 31(2) of Proposed Business Conduct Rule. On this basis, we are of the view that Section 27(3)(c) of the Proposed Instrument can be deleted in its entirety.

**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?*

ISDA notes that Sections 27 through 29 of the Proposed Instrument overlap in significant ways with the conduct obligations proposed for senior derivatives managers in the Proposed Business Conduct Rule. ISDA is concerned with how these requirements overlap, and overlap with other roles and responsibilities prescribed under NI 31-103 or banking regulations. The CSA should avoid overlapping requirements wherever possible to avoid undue compliance burdens on registered derivatives firms.

In particular, the regulatory reporting requirement in Section 27(3)(d) of the Proposed Instrument, which are duplicative of the reporting requirements in Section 32 of the Proposed Business Conduct Rule, are not appropriate. First, there is unnecessary confusion and complexity that results from overlapping compliance requirements in the two instruments.

Second, while ISDA strongly supports that derivatives firms must identify and resolve compliance issues that may arise, and further that derivatives firms should be encouraged to self-report material violations of securities legislation to the regulators, ISDA disagrees with the proposed requirement for derivatives firms to self-report material non-compliance on a “timely basis”. ISDA believes that imposing a self-reporting requirement greatly exceeds the scope of the Proposed Registration Rule and the Proposed Business Conduct Rule, particularly given that there are no similar self-reporting requirements for other market participants under applicable provincial securities law. The CSA has not provided any justification as to why derivatives firms registered in Canada should be held to a significantly different standard than securities firms registered in Canada or derivatives firms under similar regulatory regimes outside of Canada. In the absence of any such justification, ISDA respectfully requests that the CSA to re-consider the self-reporting requirement, or significantly alter the requirement to focus on periodic reporting (annually or quarterly) that assesses the firm’s compliance with applicable derivatives regulations in Canada. At a minimum, the CSA should permit Section 27(1)(d) to become an obligation that could be fulfilled by the derivatives chief compliance officer or the derivatives chief risk officer (similar to our recommendations on board reporting above) and insert the word “material” before “non-compliance” in Section 27(1)(d).

## **10. 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?*

ISDA submits that the requirements in Section 39 of the Proposed Instrument should apply only to registered derivatives dealers which are counterparties to derivatives trades i.e. not to registered dealers that are acting as an intermediary for a registered firm, or to registered advisers. It is unclear how this is meant to apply in the context of a derivatives adviser acting for its client. The risks are to the derivatives party in this scenario and not “to the registered derivatives firm”.

ISDA has the following specific comments on the proposed minimum requirements for risk management policies and procedures:

- Section 39(3)(a): the CSA should delete the words “specific derivatives or”. It should be sufficient to identify the material risks of “types of 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. Alternatively, the CSA may wish to consider changing the words “specific derivatives or” to “specific novel derivatives”.
- Section 39(3)(d): the word “material” should be inserted before the words “risks and risk tolerance limits”.
- Section 39(3)(f): the board reporting requirement should be replaced by a requirement to report to the derivatives chief risk officer. The more fulsome board reporting that is done by the derivatives chief risk officer in accordance with Section 29(3)(d) should be sufficient.
- 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.
- 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 (see, for example, Section 27(3)(c) of the Proposed Registration Rule and Section 32 of the Proposed Business Conduct Rule).
- Section 39(3)(g)(iii): the requirement for board reporting that appears in this Section should be replaced with a requirement to report to the derivatives chief risk officer. This is appropriate, taking into account the board reporting that is performed by the derivatives chief risk officer in accordance with Section 29(3)(d).

- Section 39(4): there should not be a requirement for an “independent” review of risk management systems. This would significantly add to the cost and burden of compliance without clear justification. This requirement is also inconsistent with the approach taken by other major regulators.

#### **11. Exemptions from the requirement to register for derivatives dealers with limited derivatives**

*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?*

Section 50(2)(c) of the Proposed Instrument provides for an exemption from registration where a dealer's gross notional amount under derivatives does not exceed a prescribed threshold. It is contemplated by the Proposed Registration Rule that Canada-based dealers will need to do a notional calculation based on their global book while foreign dealers will count only derivative transactions with Canadian counterparties. ISDA does not appreciate the rationale for this distinction. Notional calculations should be performed on a province-by-province basis. For example, under the latter formulation if either a Canada-based or foreign derivatives dealer is under the notional amount threshold with counterparties in the Yukon but over the notional amount threshold with counterparties in Quebec, the Canada-based and foreign derivatives dealer would be treated equitably, in that each would only have to register in Quebec but not the Yukon.

ISDA notes that Regulation 1.3 of the CFTC restricts the consideration of the gross notional of swap positions connected with a person's dealing activity in determining whether the person qualifies for the *de minimis* exception from registration as a swap dealer<sup>8</sup>, and that swaps entered into for the purpose of hedging physical positions are not considered in determining whether a person is a swap dealer<sup>9</sup>. A similar approach is recommended for Canada.

The CSA should also clarify when an entity (and relevant individuals) would be required to register once it can no longer meet one of the exemptions, and when would an entity be allowed to de-register after satisfying the requirements for the exemptions. Specifically, the entity should be permitted to register no later than two months after the end of the month in which the entity

<sup>8</sup> CFTC Regulation § 1.3 (ggg)(4) (de minimis exception for swap dealer registration)

<sup>9</sup> CFTC Regulation § 1.3 (ggg)(6)(iii) (swaps entered into for hedging physical positions as defined in the rule are not considered in the determination of whether a person is a swap dealer)

becomes no longer able to take advantage of the exemption, following Regulation 1.3 of the CFTC<sup>10</sup>, and to de-register no more than two months after satisfying the requirements of the exemptions.

## **12. Exemptions from specific requirements in this Instrument for investment dealers**

*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.*

At this time, it is not possible to comment on Section 55 of the Proposed Instrument absent the publication of Appendix E (Exemptions for IIROC Dealer Members). ISDA looks forward to commenting on Section 55 of the Proposed Instrument upon the publication of Appendix E and a republication of the Proposed Registration Rule.

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<sup>10</sup> CFTC Regulation § 1.3 (ggg) (4)(iii) (registration period for persons that can no longer take advantage of the [de minimis] exception)