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VIA ELECTRONIC MAIL

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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c/o:

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Re: Comments on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy 93-102

Dear Sir or Madam:

I. INTRODUCTION

On behalf of The Canadian Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP submits this letter in response to the request for public comment from the Canadian Securities Administrators ("**CSA**") on Proposed National Instrument 93-102 *Derivatives: Registration* ("**Proposed NI 93-102**") and the related Proposed Companion Policy 93-102 ("**Proposed Registration Companion Policy**") (collectively, the "**Proposed Instrument**").¹ The Working Group appreciates the CSA's

¹ See CSA Notice and Request for Comment on Proposed National Instrument 93-102 *Derivatives: Registration* and Proposed Companion Policy (Apr. 19, 2018) ("**CSA Notice**"), <http://www.albertasecurities.com/Regulatory%20Instruments/5399899%20%20CSA%20Notice%2093-102.pdf>.

ongoing hard work throughout the derivatives regulatory reform process and offers these comments to further advance that process.

The Working Group is a diverse group of commercial firms that are active in the Canadian energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. The Working Group considers and responds to requests for comment regarding developments with respect to the trading of energy commodities, including derivatives, in Canada.

II. COMMENTS OF THE WORKING GROUP

A. The Scope of the General De Minimis Exemption (Section 50) and the Commodity De Minimis Exemption (Section 51) Should Be Modified to Reflect the Likely Intent

The Working Group greatly appreciates that the CSA included the General De Minimis Exemption and the Commodity De Minimis Exemption in the Proposed Instrument.² Their inclusion in any final rule, with the modifications suggested below, will provide a much needed bright line to allow participants in the commodity derivatives markets to operate with a meaningful degree of regulatory certainty that they will not unexpectedly be required to register as a derivatives dealer. However, with respect to both de minimis exemptions, there are issues regarding the following that should be addressed: (i) treatment of affiliated entities; (ii) the type of transactions that are counted toward the threshold; and (iii) the relationship between the General De Minimis Exemption and the Commodity De Minimis Exemption.

i. Treatment of Affiliated Entities

Under one reading of the de minimis exemptions, Canadian companies could be at a material disadvantage with respect to the treatment of their affiliates as compared to non-Canadian companies. Specifically, both de minimis exemptions state that an entity “that has its head office or principal place of business in a jurisdiction of Canada” must include not only all outstanding derivatives to which it is a counterparty, but also all outstanding derivatives positions of “each affiliated entity” of the company when determining whether it has exceeded either de minimis exemption threshold.³ If an entity “has its head office and principal place of business in a foreign jurisdiction,” it must include all outstanding derivatives that have a Canadian counterparty as well as the derivatives positions of “each affiliated entity” of the company when determining whether it has exceeded either de minimis exemption threshold.⁴

It is clear that Canadian entities must include all of their derivatives in the de minimis analysis and foreign entities need only include their derivatives with Canadian counterparties.

² The Proposed Instrument provides an exemption from the requirement to register as a derivatives dealer for a company that does not have more than \$250 million in aggregate gross notional amount outstanding and meets certain conditions (the “**General De Minimis Exemption**”) and an exemption from the requirement to register as a derivatives dealer for a company that: only engages in the business of trading “commodity derivatives”; does not have more than \$1 billion in aggregate gross notional amount outstanding; and meets certain conditions (the “**Commodity De Minimis Exemption**”). See Proposed NI 93-102 at Sections 50 and 51.

³ See Proposed NI 93-102 at Sections 50(2)(c)(i) and 51(3)(d)(i). For the Commodity De Minimis Exemption, this would apply to “outstanding commodity derivatives.”

⁴ See Proposed NI 93-102 at Sections 50(2)(c)(ii) and 51(3)(d)(ii). For the Commodity De Minimis Exemption, this would apply to “outstanding commodity derivatives.”

What is not clear is the extent to which affiliate derivatives are included in the de minimis analysis.

The Working Group believes that the CSA intended that affiliates be treated like the entities under analysis so that an affiliate located outside of Canada would only include transactions with Canadian counterparties included in the de minimis analysis and an affiliate located in Canada would have all its transactions included in the de minimis analysis of the relevant entity regardless of where that entity is located.

However, Sections 50 and 51 of the Proposed Instrument could be read to require a Canadian entity to include all of its affiliates' market facing derivatives in its analysis regardless of where those affiliates are domiciled while a non-Canadian entity would only include the market facing transactions of its affiliates with Canadian counterparties, regardless of where such affiliates are domiciled. If this approach to the de minimis exemptions was the intended approach, it would put Canadian entities at a material disadvantage as they would be more likely to lose the availability of the de minimis exemptions based on their affiliates' activity outside of Canada.

Therefore, the Working Group requests that the CSA clarify that all of a Canadian domiciled affiliate's transactions would be included in an entity's de minimis analysis and, with respect to a non-Canadian affiliate, only the affiliate's transactions with Canadian counterparties would be included in an entity's de minimis analysis, regardless of where the entity conducting the de minimis analysis is domiciled.

ii. Only Dealing Activity Should Be Counted Towards the Threshold for Both De Minimis Exemptions

Only dealing activity should be counted towards the threshold for both the General De Minimis Exemption and the Commodity De Minimis Exemption. Under the Proposed Instrument, both de minimis exemptions disadvantage corporate families with large non-dealing derivatives portfolios. The two de minimis exemptions use a notional amount threshold that is based on, with certain limitations, an entity and its affiliates' overall derivatives activity – not just their derivatives dealing activity. Basing the de minimis exemption thresholds on all of an entity's derivatives activity rather than the activity relevant to the exemptions (*e.g.*, dealing activity) may make the exemptive relief unavailable or limit its efficacy for companies with large hedging portfolios. A properly calibrated de minimis exemption would look only at the dealing activity of the relevant market participants, and the Working Group suggests that the CSA amend the Proposed Instrument to reflect this.

At a minimum, the Working Group respectfully requests that the CSA expressly exclude transactions that are intended to hedge or mitigate commercial risk from the determination of whether an entity exceeds either de minimis exemption. Doing so would make both of those exemptions available to larger corporate families that hedge financial risks (*e.g.*, interest rate risk from variable rate financings) or physical commodity risks (*e.g.*, the cost of natural gas needed to run a power plant).

Further, excluding transactions intended to hedge or mitigate commercial risk would provide cross-border consistency with the approach taken in the United States by the Commodity Futures Trading Commission (the "CFTC") as well as in the European Union. For example, under the CFTC Regulations, transactions that hedge physical commodity risk are not considered swap dealing activity and do not factor into the CFTC's swap dealer de minimis

exception analysis.⁵ In the European Union, under EMIR,⁶ OTC transactions intended to hedge or mitigate commercial risk are excluded from the determination of whether an entity is subject to heightened regulatory requirements.⁷

To provide clarity to market participants and regulators alike, the CFTC and the EU regulators have provided guidance in a number of circumstances on what constitutes a qualifying hedge, and the CSA could do so as well.⁸ Further, to confirm that market participants are applying the relevant guidance properly, the CFTC has the “special call” authority, which allows it to request information from market participants.⁹ In this respect, the Proposed Instrument could be revised so that any de minimis exemption that excludes transactions intended to hedge or mitigate commercial risk would be conditioned on the market participant demonstrating, upon specific request from the relevant provincial regulator, a reasonable basis for its characterization of a transaction as a hedge.

⁵ Specifically, in the United States:

- CFTC Regulation 1.3 (swap dealer definition ¶(6)(iii)) excludes from the swap dealer analysis swaps entered into for the purpose of hedging physical positions.
- The CFTC has also proposed rules intended to clarify that swaps that hedge physical or financial positions are excluded from the swap dealer de minimis exception threshold. See CFTC Notice of Proposed Rulemaking, *De Minimis Exception to the Swap Dealer Definition*, 83 Fed. Reg. 27,444 (June 12, 2018), <https://www.cftc.gov/sites/default/files/2018-06/2018-12362a.pdf> (proposing CFTC Regulation 1.3 (swap dealer definition ¶(4)(i)(D))).
- In addition, “Congress incorporated a de minimis exception to the swap dealer definition to ensure that smaller institutions that are responsibly managing their commercial risk are not inadvertently pulled into additional regulations.” 156 Cong. Rec. S6192 (July 22, 2010) (letter from Senators Dodd and Lincoln to Representatives Frank and Paterson), <https://www.congress.gov/crec/2010/07/22/CREC-2010-07-22-txt-PgS6192.pdf>.
- CFTC Regulation 1.3 (major swap participant definition ¶(1)(ii)) excludes from the major swap participant analysis positions held for hedging or mitigating commercial risk.

⁶ Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories (“EMIR”), <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ%3AL%3A2012%3A2012%3A0001%3A0059%3AEN%3APDF>.

⁷ Specifically, in the European Union, under EMIR, the determination of whether a non-financial counterparty exceeds a threshold (*i.e.*, an “NFC+”) that would subject it to a number of regulatory requirements (*e.g.*, mandatory clearing and margin requirements) excludes from the calculation OTC derivatives transactions that are objectively measurable as reducing risks directly relating to commercial activity or the treasury activity of an NFC or its group. EMIR Article 10 Section 3.

⁸ For example:

- CFTC Regulation 1.3 defines “hedging or mitigating commercial risk” for use in certain contexts.
- CFTC Regulation 50.50(c) discusses when a swap is used to hedge or mitigate commercial risk for purposes of the end-user exception from mandatory clearing and mandatory exchange execution.
- European Commission Delegated Regulation (EU) No. 149/2013 of 19 December 2012, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0149&from=EN> (discussing hedging).

⁹ See, *e.g.*, CFTC Regulations Part 21.

iii. Relationship Between the General De Minimis Exemption and the Commodity De Minimis Exemption

The Working Group is seeking clarification regarding the relationship between the General De Minimis Exemption and the Commodity De Minimis Exemption. It is the Working Group's understanding that the Commodity De Minimis Exemption would be available to an entity that:

- has non-commodity derivatives (*e.g.*, interest rate swaps) with a gross notional amount over \$250 million;
- would not be considered a derivatives dealer with respect to its activities regarding any of its non-commodity derivatives; and
- has commodity derivatives with a gross notional amount that is less than \$1 billion.

In the above example, it is the Working Group's understanding that the entity would be eligible for the Commodity De Minimis Exemption even though it would not be eligible for the General De Minimis Exemption. The Working Group requests that the CSA confirm that the Working Group has correctly interpreted the application of the General De Minimis Exemption and the Commodity De Minimis Exemption in the example above.

B. The Definition of "Eligible Derivatives Party" Should Be Broadened so That It Is Consistent with Existing Derivatives Regulations

As the CSA is aware, the Proposed Instrument imposes different regulatory requirements on market participants based on the types of counterparties with whom they transact. It does so by importing a concept from the 2017 Proposed Business Conduct Instrument, which separates the derivatives market into two main groups – (i) market participants who are sophisticated or have adequate financial resources (*i.e.*, eligible derivatives parties ("**EDPs**") and (ii) market participants who are less sophisticated or lack adequate financial resources (*i.e.*, non-eligible derivatives parties ("**Non-EDPs**")) – under the theory that the latter group requires extra customer protections.

The Proposed Instrument imports the EDP concept in the context of (i) its registration requirements, which, among other things, are triggered by certain interactions with Non-EDPs; and (ii) certain registration exemptions, which are not available if a derivatives firm deals with or advises a Non-EDP.¹⁰ Accordingly, the scope of the definition of EDP is an integral part of the regulatory regime contemplated in the Proposed Instrument and the Proposed Business Conduct Instrument. As such, the Working Group appreciates that the CSA revised the EDP definition in the Proposed Instrument based on comments submitted on the EDP definition in the 2017 Proposed Business Conduct Instrument. The EDP definition in the Proposed Instrument is an improvement as it considers a separate threshold for commercial hedgers and the ability to rely upon a guarantee from certain affiliated EDPs. However, the proposed EDP definition still presents several issues, as further discussed below.

The primary issue with the current proposed definition of EDP is that the asset thresholds for certain types of entities remain too high. The Working Group understands that the general \$25 million net asset threshold for companies¹¹ is based on the "permitted client" definition in National Instrument 31-103 and that the proposed \$10 million net asset threshold

¹⁰ See CSA Notice at 5.

¹¹ See Proposed NI 93-102 at Section 1(1) (EDP definition ¶(m)).

for commercial hedgers¹² reflects an important difference between securities markets and derivatives markets, which are widely used to hedge commercial risk, while securities markets are not.¹³

However, the \$10 million commercial hedger threshold, while an improvement, is still too high. There are material benefits to providing an EDP threshold lower than \$10 million in net assets for commercial hedgers. At a conceptual level, a lower threshold will encourage risk management through the use of derivatives, which is desirable. A lower threshold may also ensure that smaller commercial market participants continue to have access to a liquid and competitive market as they have more available counterparties who are able to rely upon the exemptive relief in the Proposed Instrument that is available to market participants that transact only with EDPs. As the Working Group has previously highlighted, in the United States, imposing registration obligations on market participants that engage in limited dealing activity with certain types of entities may not protect such entities and may, in fact, harm them by limiting the number of available counterparties and reducing market liquidity.¹⁴

Commercial hedgers with less than \$10 million in net assets generally do not need retail-level customer protections. The policy rationale underlying the decision to provide commercial hedgers a \$10 million rather than \$25 million net asset threshold is based on the degree of sophistication that smaller market participants have with respect to the risks faced in their day-to-day business. That policy rationale also underlies regulatory paradigms similar to the EDP paradigm that apply a lower (*e.g.*, less than \$10 million) or no threshold to commercial hedgers. For example, various provinces' existing blanket orders (collectively, the "**Exemption Blanket Orders**"),¹⁵ among other things, effectively exempt market participants from the obligation to register as a derivative dealer if they limit their derivatives counterparties to "qualified parties," and Section 7 of the Québec Derivatives Act takes a similar approach by excluding transactions between "accredited counterparties"¹⁶ from consideration when determining whether an entity must register as a derivatives dealer. Both the various definitions of "qualified party" and the definition of "accredited counterparty" allow commercial hedgers to qualify as such without satisfying an asset threshold of any kind. Further, in the United States, the Commodity Exchange Act ("**CEA**") allows commercial hedgers to qualify as "eligible contract participants" (allowing them to enter into swaps) with

¹² See Proposed NI 93-102 at Section 1(1) (EDP definition ¶(n)).

¹³ See CSA Notice at 5-6.

¹⁴ See The Canadian Commercial Energy Working Group White Paper (Attached to the Comment Letter on the 2017 Proposed Business Conduct Instrument) at (Aug. 15, 2017), https://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20170815_93-101_canadian-commercial-energy.pdf (discussing issues related to "special entities").

¹⁵ See Alberta Securities Commission Blanket Order 91-507 *Over-the-Counter Derivatives* (Jan. 23, 2017), http://www.albertasecurities.com/Regulatory%20Instruments/5330057%20_%2091-507_OTC_Trades_in_Derivatives.pdf; British Columbia Securities Commission Blanket Order 91-501 *Over-the-Counter Derivatives* (Nov. 24, 1999), https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/91-501_BCI_/; Manitoba Securities Commission Blanket Order 91-501 *Over-the-Counter Trades in Derivatives* (Oct. 26, 2015) <https://docs.mbsecurities.ca/msc/notices/en/120617/1/document.do>; Financial and Consumer Services Commission (New Brunswick) Local Rule 91-501 *Derivatives* (consolidated up to Jan. 11, 2015), http://www.nbsc-cvmnb.ca/nbsc/uploaded_topic_files/91-501-LR-CONS-2015-01-11-E.pdf; Nova Scotia Securities Commission Blanket Order 91-501 *Over the Counter Trades in Derivatives* (Feb. 17, 2016), <https://nssc.novascotia.ca/sites/default/files/docs/Blanket%20Order%2091-501%20Feb%2017%202016%20OTC%20Derivatives.pdf>.

¹⁶ See Québec Derivatives Act at Section 3 (defining "accredited counterparty"), https://www.canlii.org/en/qc/laws/stat/cqlr-c-i-14.01/latest/cqlr-c-i-14.01.html#sec3_smooth.

only \$1 million in net worth.¹⁷ In each of these circumstances, regulators appear to have weighed the benefits and risks associated with treating smaller commercial hedgers in a manner similar to or the same as other sophisticated, but larger, market participants and determined that low or no “qualifying thresholds” are justified. The Working Group respectfully urges the CSA to follow that reasoning and lower the commercial hedger EDP threshold¹⁸ to \$1 million in net assets.

To the extent the CSA decides to retain the proposed \$25 million general and \$10 million commercial hedger EDP thresholds, the Working Group suggests for the CSA to make those thresholds based on total assets rather than net assets. If the intent of the asset thresholds is to serve as a proxy for the size and degree of sophistication of market participants, then total assets is a better metric. Total assets is a measure of the “size” of a business, while net assets is effectively a proxy for shareholders’ equity. In fact, with respect to the general asset thresholds for entities in the definitions of “qualified party” and “eligible contract participant,” the focus is on total assets rather than net assets, and the CSA should do the same in the Proposed Instrument.¹⁹

C. The Approach to the Calculation of Notional Amount Should Be Revised

i. Overview

The Working Group appreciates the CSA including two forms of potential guidance on the calculation of notional amount in the Proposed Instrument.²⁰ For commodity derivatives market participants, the approach to the calculation of notional amount is key to evaluating the usefulness of the two de minimis thresholds in the Proposed Instrument as well as the utility of existing regulatory exemptive relief.²¹

As the Working Group has noted to the CSA previously, market participants often think of the notional amount of commodity derivatives in terms of the volume of the underlying commodity, not in a dollar amount.²² This is different than how the notional amount of other

¹⁷ See CEA Section 1a(18).

¹⁸ See Proposed NI 93-102 at Section 1(1) (EDP definition ¶(n)).

¹⁹ See Alberta Securities Commission Blanket Order 91-507 *Over-the-Counter Derivatives* (Jan. 23, 2017); British Columbia Securities Commission Blanket Order 91-501 *Over-the-Counter Derivatives* (Nov. 24, 1999); Manitoba Securities Commission Blanket Order 91-501 *Over-the-Counter Trades in Derivatives* (Oct. 26, 2015); Financial and Consumer Services Commission (New Brunswick) Local Rule 91-501 *Derivatives* (consolidated up to Jan. 11, 2015); Nova Scotia Securities Commission Blanket Order 91-501 *Over the Counter Trades in Derivatives* (Feb. 17, 2016); Financial and Consumer Affairs Authority of Saskatchewan General Order 91-908 *Over-the-Counter Derivatives* (Feb. 29, 2016).

²⁰ See CSA Notice at Annex I (CSA Notice at 24-25).

²¹ For example, each Canadian jurisdiction’s derivatives reporting rule provides a limited exclusion from the reporting requirements if the transaction relates to a derivative the asset class of which is a commodity other than cash or currency and certain conditions are met, including aspects related to the calculation of notional amount. See, e.g., Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* (the “**MI Reporting Instrument**”) at Section 40. In addition, the calculation of notional amount is relevant for purposes of determining whether transactions with certain counterparties are subject to the mandatory central clearing requirement. See National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* at Section 3(1)(c).

²² See The Canadian Commercial Energy Working Group Comments on CPMI-IOSCO Batch Three Report at 16 (Sept. 2017), <https://www.bis.org/cpmi/publ/comments/d160/tccewg.pdf> (noting that “[c]ommodity derivative market participants typically do not measure their derivatives activity in terms of notional amounts denominated in an amount of a particular currency. Notional amount, if measured

derivatives is determined, such as interest rate derivatives which is a dollar amount set in the terms of the contract. The difficulty with commodity derivatives is determining how to convert that volume-based notional amount to a dollar amount-based notional amount.

Of the two proposed approaches to the calculation of notional, the approach based on the CPMI-IOSCO Batch Three Report ("**CPMI-IOSCO Methodology**")²³ largely does not reflect market participants' understanding of the notional amount of commodity derivatives. The Regulatory Notional Methodology does a better job of reflecting market participants' understanding of the notional amount of commodity derivatives, but still requires a few changes.

ii. Comparison of the CPMI-IOSCO Methodology and the Regulatory Notional Methodology

As the Working Group stated in response to the request for comments on the CPMI-IOSCO Methodology, that methodology does not properly reflect the common practice in commodity derivatives markets with respect to the calculation of notional amount.²⁴ The CPMI-IOSCO Methodology is one small part of a larger effort to standardized derivatives reporting across jurisdictions. The CSA should not feel bound to adopt the CPMI-IOSCO Methodology for the purposes of Canada's domestic regulatory requirements such as the General De Minimis Exemption and the Commodity De Minimis Exemption. Doing so would be consistent with the approach taken by the CFTC, which stated that the CPMI-IOSCO Methodology "does not necessarily address how notional amounts should be calculated for purposes of the de minimis exception under CFTC regulations."²⁵

The Regulatory Notional Methodology is more workable than the CPMI-IOSCO Methodology and, in some circumstances, properly reflects the market's view. For example, under the CPMI-IOSCO Methodology, the notional amount of an option would be calculated by multiplying the volume underlying the option and the strike price of the option. That approach does not account for the likelihood of the option being struck and can grossly overstate the notional amount of the option. Under the Regulatory Notional Methodology, the notional amount would be the delta adjusted spot price of the commodity underlying the option multiplied by the notional volume of the option. By using delta,²⁶ this approach does account for the likelihood of the option being struck. Further, the Regulatory Notional Methodology's use of a monthly equivalent amount for the volume in the Regulatory Notional Methodology is a meaningful step in making the notional amount of commodity derivatives comparable to that of other asset classes and is consistent with market participants' approach to the issue.

The one part of the Regulatory Notional Methodology that is not consistent with common market practice is with respect to its treatment of float-for-float swaps. Specifically,

at all, is thought of in terms of the measure of the underlying volume of the relevant commodity (*i.e.*, barrels for crude oil)).

²³ See CPMI-IOSCO Consultative Report, Harmonisation of Critical OTC Derivatives Data Elements (Other Than UTI and UPI) – Third Batch (June 2017) ("**CPMI-IOSCO Batch Three Report**"), <https://www.bis.org/cpmi/publ/d160.pdf>.

²⁴ See The Canadian Commercial Energy Working Group Comments on CPMI-IOSCO Batch Three Report at 16.

²⁵ CFTC De Minimis Exception Proposal at 27,464.

²⁶ It is unclear what would be acceptable sources for the deltas used to calculate the notional amount of options. Market participants should be able to use: (i) deltas published by exchanges, when available; or (ii) their own deltas calculated using reasonable assumptions, when no exchange delta is available.

the Regulatory Notional Methodology would multiply the higher of the two floating prices by the relevant volume. However, market participants view the price of a float-for-float transaction as the difference between the two floating prices since this type of swap is entered into to gain exposure to the relationship between the two prices (e.g., the price difference between natural gas at two locations or the price difference between crude oil and gasoline). As such, the Working Group requests for the CSA to adopt the Regulatory Notional Methodology modified to use the difference between the two floating prices as the price when calculating the notional amount of float-for-float swaps.

In the Proposed Instrument, the CSA requests comment on the “most appropriate approach to determining notional amount for a multi-leg derivative.”²⁷ Structured multi-leg transactions should be viewed as one transaction if they are assembled to create one net exposure by combining different instruments executed in conjunction with one another. For example, a natural gas producer might buy a put option at \$2.50 and sell a call option at \$3.50. Those two transactions are inextricably linked. The premiums paid for the downside protection of the put option would be offset by the premiums generated by limiting the producer’s upside by selling the call option and the producer would have a limited band in which the price of its natural gas could move. As such, the Working Group recommends treating collars and similar transactions as having a single notional amount – not a notional amount for each leg. This is also consistent with the CFTC’s stated approach for the calculation of notional amount.²⁸

In addition, the CSA states:

If the Regulatory Notional Methodology is adopted, we expect that we would implement a notional amount threshold in section 51 that is smaller than the proposed \$1 billion threshold. Based on our analysis of trade reporting data, we anticipate that the threshold in [S]ection 51 would be in the range of \$250 million to \$500 million but note that this threshold may be significantly lower following further analysis.²⁹

However, the Working Group believes that until the CSA has clear data on the various levels of derivatives dealing activity in the various markets, \$1 billion is an appropriate threshold under the Regulatory Notional Methodology, if that methodology and the scope of the Commodity De Minimis Exemption are amended as proposed herein. Only once the CSA has a clear picture on how any final derivatives dealer registration rule might impact the Canadian commodity derivatives markets should the CSA consider dropping the Commodity De Minimis Exemption threshold below \$1 billion.

D. The Relationship Between the Proposed Instrument and Other Regulatory Instruments Should Be Clarified

As set out in the Proposed Instrument, the so-called “business trigger” is used to determine whether an entity must register as a derivatives dealer, unless an exemption applies. However, the relationship between the registration requirement in the Proposed Instrument and other regulatory instruments, such as the MI Reporting Instrument and the Proposed Business Conduct Instrument, is unclear. In particular, both the MI Reporting Instrument and the Proposed Business Conduct Instrument do not rely on the registration status of an entity for purposes of the requirements in those instruments – they rely on the

²⁷ See CSA Notice at 19.

²⁸ See CFTC Frequently Asked Questions, Division of Swap Dealer and Intermediary Oversight Responds to FAQs About Swap Entities (Oct. 12, 2012), https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/swapentities_fa_q_final.pdf.

²⁹ See CSA Notice at 7.

business trigger analysis. Further, the MI Reporting Instrument and the Proposed Business Conduct Instrument provide different exemptions than the Proposed Instrument.

This construct could result in an entity that would be exempt from registration under the Proposed Instrument being subjected to requirements imposed on derivatives dealers under other instruments. For example, an entity might be exempt from registration under the Commodity De Minimis Exemption, but required to report as a derivatives dealer, and might not qualify for any exemptive relief available in the Proposed Business Conduct Instrument. This is an incongruous result. To avoid this outcome, the Working Group strongly suggests that the CSA amend existing derivatives regulations and revise the Proposed Business Conduct Instrument to define a derivatives dealer as an entity that is either (i) registered as such in a Canadian jurisdiction or (ii) exempt from registration under Section 52 of the Proposed Instrument.

E. An Alternative Path for Derivatives Chief Compliance Officer and Derivatives Chief Risk Officer Qualification Is Needed

The Working Group understands the CSA's motivation in proposing qualification requirements for Derivatives Chief Compliance Officers ("**CCOs**") and Derivatives Chief Risk Officers ("**CROs**"). Having experienced and qualified personnel in risk and compliance positions with important market participants should be beneficial to the market generally. However, there may not be many candidates that meet the strict requirements set out in the Proposed Instrument. As such, the Working Group suggests that the CSA amend the Proposed Instrument to allow individuals that pass the required competency exam to petition the relevant regulator to qualify for a position as a CCO or CRO if they do not meet the other requirements set out in the Proposed Instrument.

F. The Foreign Dealer Exemption Will Support Liquidity in Canadian Markets

As the CSA is aware, the Proposed Instrument contemplates an exemption from the requirement to register as a derivatives dealer for a company with its head office or principal place of business in a foreign jurisdiction that has equivalent regulatory requirements, subject to certain conditions (the "**Foreign Derivatives Dealer Exemption**").³⁰ Among other things, an entity utilizing the Foreign Derivatives Dealer Exemption must be registered in the relevant foreign jurisdiction to conduct the derivatives activities in that foreign jurisdiction it proposes to conduct with Canadian counterparties and the entity must be subject to and comply with relevant regulatory requirements in the foreign jurisdiction.³¹

The Working Group believes that this exemption strikes the proper balance between ensuring that foreign dealers are subject to an appropriate level of regulation while allowing access to Canadian derivatives markets with minimal additional regulatory burden. This exemption will allow foreign dealers to provide Canadian market participants with valuable liquidity.

³⁰ See Proposed NI 93-102 at Section 52.

³¹ See Proposed NI 93-102 at Section 52.

III. CONCLUSION

The Working Group appreciates this opportunity to provide input on the Proposed Instrument and respectfully requests that the comments set forth herein are considered.

If you have any questions, please contact the undersigned.

Respectfully submitted,
/s/ Alexander S. Holtan
Alexander S. Holtan
Blair Paige Scott