

March 30, 2015

**VIA ELECTRONIC MAIL**

Alberta Securities Commission  
Autorité des marchés financiers  
British Columbia Securities Commission  
Manitoba Securities Commission  
Financial and Consumer Services Commission (New Brunswick)  
Nova Scotia Securities Commission  
Ontario Securities Commission

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**Re: Comments on CSA Consultation Paper 92-401 Derivatives Trading Facilities**

Dear Sir or Madam:

On behalf of The Canadian Commercial Energy Working Group (the “**Working Group**”), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the request for public comment on CSA Consultation Paper 92-401 Derivatives Trading Facilities (“**Consultation Paper 92-401**”) published by the Canadian Securities Administrators (“**CSA**”) Derivatives Committee.<sup>1</sup> The Working Group welcomes the opportunity to provide comments on Consultation Paper 92-401 and looks forward to working with the CSA throughout the derivatives reform process.

As the drafting process continues, it is critical for the CSA to ensure that the regulatory framework for derivatives trading facilities (“**DTFs**”) and the rules regarding the trade execution mandate are compatible with and accommodating of the unique characteristics of the over-the-counter (“**OTC**”) derivatives market. With this in mind, the Working Group’s comments

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<sup>1</sup> CSA Consultation Paper 92-401 Derivatives Trading Facilities (Jan. 29, 2015), available at [http://www.albertasecurities.com/Regulatory%20Instruments/5043114-v1-CSA\\_Consultation\\_Paper\\_92-401\\_-\\_Derivatives\\_Trading\\_Facilities.pdf](http://www.albertasecurities.com/Regulatory%20Instruments/5043114-v1-CSA_Consultation_Paper_92-401_-_Derivatives_Trading_Facilities.pdf).

contained herein identify issues and offer recommendations designed to ensure a workable regulatory framework for DTFs and rules regarding the trade execution mandate.

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.

## **I. INTRODUCTION.**

As Consultation Paper 92-401 sets forth a proposed regulatory framework for DTFs and the trade execution mandate, issues pertaining to the following topics should be addressed in the drafting process: (i) the role of voice brokers; (ii) the absence of exemptions from the trade execution mandate for end-users and intragroup transactions; (iii) the relationship between the determination process for mandatory trade execution and mandatory central clearing; (iv) the process to determine which OTC derivatives or classes of OTC derivatives are subject to the trade execution mandate as it relates to consistent application and market participants' input; (v) the definition of "OTC derivative;" (vi) the potentially insufficient public reporting delay; and (vii) the treatment of foreign DTFs. Each of these issues will be discussed in detail below.

## **II. COMMENTS OF THE WORKING GROUP.**

### **A. The Obligations of Standalone Voice Brokers Are Unclear.**

Under Consultation Paper 92-401, it is unclear what the obligations would be for a brokerage firm that only offers voice execution (*i.e.*, a "**standalone voice broker**"). This uncertainty primarily stems from the question of whether a standalone voice broker is a many-to-many platform, and thus falls under the scope of the DTF definition. Although Consultation Paper 92-401 does not directly answer this question, a standalone voice broker should fall outside of the scope of the DTF definition.

A standalone voice broker typically takes an order from one customer and then finds that customer a counterparty to the requested derivatives transaction. Unlike execution facilities where multiple sellers and multiple buyers come together to collectively engage in trading activity, a standalone voice broker handles transactions for single buyers or single sellers. The fact that a standalone voice broker might call multiple parties is irrelevant. While a standalone voice broker might be trying to facilitate a transaction for a number of customers at the same time, that standalone voice broker is trying to match a counterparty with each one of those customers – it is not matching multiple bids against multiple offers.

In short, a standalone voice broker does not facilitate a many-to-many trading environment, and there is no multiple-to-multiple trading occurring. Comments by the U.S. Commodity Futures Trading Commission ("**CFTC**") in the preamble to its final rule on swap

execution facilities (“SEFs”) support this position.<sup>2</sup> Specifically, the CFTC noted that “trading systems or platforms facilitating...execution...via voice exclusively are not multiple participant to multiple participant....”<sup>3</sup> Accordingly, a standalone voice broker should fall outside of the scope of the DTF definition.

If a standalone voice broker is considered a DTF under Consultation Paper 92-401, the Working Group is concerned that the proposed regulatory obligations for a DTF may compromise the traditional role of a standalone voice broker in commodity derivatives markets in two main ways. *First*, many of the potential requirements imposed on DTFs (*e.g.*, keeping electronic records of all bids and offers and “messages” sent to participants) are inconsistent with voice execution and may effectively prevent standalone voice brokers from operating at all if they must register as DTFs.

*Second*, the regulatory burdens under the proposed DTF framework (*e.g.*, obtaining regulatory authorization from the securities regulators in each jurisdiction) may drive some of the smaller standalone voice brokers out of the Canadian markets, potentially resulting in (i) fewer intermediaries for market participants to choose from and (ii) less liquidity in the markets.

However, to the extent standalone voice brokers are considered to be DTFs, voice execution should be a permitted execution method for OTC derivatives transactions subject to the trade execution mandate. Permitting voice execution in this context will provide market participants necessary flexibility and help preserve the integrity and function of the OTC energy derivatives market.

**Solution.** As the drafting process progresses, the Working Group respectfully recommends that amendments be made to clarify that a standalone voice broker is not a many-to-many platform and thus not a DTF. If, however, a standalone voice broker is considered to be a DTF, the Working Group respectfully suggests that the rules be extended to permit voice execution as a permissible execution method for OTC derivatives transactions subject to the trade execution mandate.

**B. The Failure to Provide Exemptions for End-Users and Intragroup Transactions Could Potentially Introduce Costs or Risks That Outweigh the Benefits of Trading OTC Derivatives.**

The Working Group appreciates the CSA’s efforts to propose a regulatory framework for OTC derivatives trading that is consistent with Canada’s G20 commitment. However, the proposed framework in Consultation Paper 92-401 does not appropriately balance the regulatory objectives with the burdens they would impose on market participants. Failure to strike an

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<sup>2</sup> See, *e.g.*, CFTC Final Rule, *Core Principles and Other Requirements for Swap Execution Facilities*, 78 Fed. Reg. 33,476, 33,500 (June 4, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-12242a.pdf>.

<sup>3</sup> See, *e.g.*, *id.*

appropriate balance could potentially introduce costs or risks that outweigh the benefits of trading OTC derivatives. To establish a balanced regulatory framework that would foster an efficient OTC derivatives market, the CSA should specifically include exemptions from mandatory trade execution for end-users and intragroup transactions.

The Working Group notes that the same arguments which support exemptions for end-users and intragroup transactions from mandatory central clearing apply in the context of the trade execution mandate. Specifically, exemptions for end-users and intragroup transactions should be included because (i) such exemptions would reduce unnecessary regulatory and economic burdens on market participants and (ii) the inclusion of such exemptions would be consistent with the recommendations of the Derivatives Committee to address Canada's G20 commitment to OTC derivatives trading.

In Consultation Paper 92-401, the Derivatives Committee recommends that the CSA pursue Option 2 to address the G20 commitment to OTC derivatives trading.<sup>4</sup> Option 2 provides that mandatory trade execution should apply only to those transactions with sufficient standardization and liquidity *and/or that pose systemic risks to the integrity of the markets.*<sup>5</sup> In this respect, an exemption for end-users would be consistent with the Derivatives Committee's recommendation since it would be limited in scope and would be available to market participants that do not pose systemic risks to the integrity of the markets. Similarly, an exemption for intragroup transactions is also consistent with the Derivatives Committee's recommendation because intragroup transactions simply represent transfers of risks *within* a corporation organization and do not pose risk to the integrity of markets.

**Solution.** The Working Group respectfully requests that exemptions from the trade execution mandate are added for end-users and intragroup transactions. The standards to qualify for these exemptions should be the same as the standards to qualify for the exemptions for end-users and intragroup transactions, respectively, in the anticipated, final National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives.<sup>6</sup>

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<sup>4</sup> Consultation Paper 92-401 at 17.

<sup>5</sup> *Id.*

<sup>6</sup> When the Working Group notes in this comment letter that the standards to qualify for the exemptions should be the same as the standards for the exemptions in the anticipated, final National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives, it means that the standards should be *consistent* – not that the proposed standards, as currently drafted in Proposed National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives (“**Proposed Clearing Rule**”), should be used. The Working Group largely supports the construct of the proposed exemptions for end-users and intragroup transactions in the Proposed Clearing Rule. However, the Working Group plans to submit comments on the Proposed Clearing Rule in advance of the May 13, 2015 deadline and will offer suggestions to improve the proposed exemptions for end-users and intragroup transactions.

**C. The Standard for OTC Derivatives or Classes of OTC Derivative to Be Subject to Mandatory Trade Execution Should Be Higher Than the Standard in the Context of Mandatory Central Clearing.**

The Working Group appreciates that the CSA contemplates separate analyses for the determination processes regarding mandatory trade execution and mandatory central clearing. The Working Group agrees that the analysis for each should be separate since each generally serves different purposes (*e.g.*, mandatory trade execution aims to increase transparency and mandatory central clearing aims to reduce credit risk). Although each generally serves different purposes, certain of the factors that regulators should consider for each determination are critical for both determinations (*e.g.*, product liquidity and product standardization). However, the Working Group respectfully suggests that the standard for OTC derivatives or classes of OTC derivatives to be subject to mandatory trade execution should be higher than the standard in the context of mandatory central clearing.

The reason for the higher standard with respect to the mandatory trade execution determination process is, in part, because more liquidity is needed to facilitate effective platform execution than mandatory central clearing.<sup>7</sup> Fostering efficient markets will, in turn, help reduce market risks. To effectively achieve this, only OTC derivatives or classes of OTC derivatives that are subject to mandatory central clearing should be considered for mandatory trade execution. The determination of whether OTC derivatives or classes of OTC derivatives are subject to mandatory trade execution should not be a *fait accompli* if an OTC derivative is already subject to mandatory central clearing.

Amendments to the mandatory trade execution determination process to require OTC derivatives or classes of OTC derivatives to first be subject to mandatory central clearing before they can be considered for mandatory trade execution would, in this respect, bring the derivatives regime in Canada in line with the regime in the United States.

**Solution.** Consultation Paper 92-401 should be amended so that the OTC derivatives or classes of OTC derivatives must first be subject to mandatory central clearing before they can be considered for mandatory trade execution.

**D. The Proposed Trade Execution Mandate Determination Process May Not Have Adequate Safeguards to Ensure Consistent Application and Would Benefit from Guaranteeing the Opportunity for Market Participants to Comment.**

The Working Group respectfully submits that the proposed process for determining which OTC derivatives or classes of OTC derivatives would be subject to the trade execution

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<sup>7</sup> It is the Working Group's understanding that a certain level of liquidity is required for a clearing house to safely clear a derivative. That level of liquidity is lower than the level of liquidity required for market participants to feel comfortable trading a derivative solely on a platform. Said another way, the level of liquidity necessary for market participants to safely enter into and exit larger positions is higher than the level of liquidity necessary to safely clear a derivative.

mandate may benefit from modifications. Specifically, the Working Group suggests that modifications could be made to (i) ensure a consistent application of the trade execution mandate within and across provinces and (ii) guarantee market participants the opportunity to provide input with respect to pending mandatory trade execution determinations.

Consultation Paper 92-401 contemplates that the regulators would make the final determination as to which OTC derivatives or classes of OTC derivatives would be subject to the trade execution mandate. This is an appropriate course for making that determination.

For the determination process, Consultation Paper 92-401 provides a proposed list of factors that the regulators should consider. While the Working Group supports the proposed factors listed, it is unclear whether the proposed list would be the universe of factors regulators could consider or if other factors may be taken into account. Without a uniform list of criteria that regulators must consider when making the trade execution mandate determination, there is potential for inconsistent application in the same province as well as across provinces. The potential lack of consistency may result in OTC derivatives or classes of OTC derivatives being subject to mandatory trade execution in one province but not in another, or it could result in derivatives with similar characteristics (*e.g.*, similar levels of liquidity and standardization) being treated differently under the trade execution mandate.

As noted above, the trade execution mandate determination process would benefit from market participants' input. Under the proposed framework in Consultation Paper 92-401, however, it is unclear if the public will be guaranteed an opportunity to comment on pending trade execution mandate determinations. Since these determinations will impact market participants, their comments should be considered in the determination process.

**Solution.** The Working Group proposes that a uniform list of factors should be considered by the regulators for the trade execution mandate determination. Such a list should provide the regulators with the flexibility to determine how much weight to give each factor. In addition, the Working Group suggests that regulators modify the proposed framework to guarantee market participants an opportunity to comment on pending mandatory trade execution determinations.

#### **E. The Definition of "OTC Derivative" Is Unclear.**

In Consultation Paper 92-401, the Derivatives Committee notes that the term "OTC derivative" refers to "a derivatives contract that is traded other than on a formal exchange."<sup>8</sup> Based on this definition, it is unclear the extent to which the definition of "OTC derivative" will be consistent with the definition of "derivative" in the Scope Rule (in Ontario, Manitoba, and Québec, the Scope Rule is numbered 91-506; in Alberta, British Columbia, New Brunswick, Nova Scotia, and Saskatchewan, the Proposed Scope Rule is numbered 91-101).

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<sup>8</sup> Consultation Paper 92-401 at 26.

**Solution.** The Working Group respectfully suggests that the regulators include explanatory guidance as to the relationship between the definition of “OTC derivative” in the context of DTFs and the definition of “derivative” in the Scope Rule.

**F. The Post-Trade Transparency Proposals Regarding Public Dissemination Requirements Are Potentially Insufficient to Protect Counterparties to a Transaction.**

The Working Group generally supports initiatives to increase transparency in derivatives markets and, as such, appreciates the importance of the proposals set forth in Consultation Paper 92-401 regarding pre- and post-trade transparency requirements. However, the Working Group is concerned that the post-trade transparency<sup>9</sup> proposals are potentially insufficient with respect to: (i) the public reporting delay; and (ii) the explanation of what qualifies as “market information.”

In Consultation Paper 92-401, the Derivatives Committee recommended that DTFs be required to publicly report transactions executed on the DTF “as close to real-time as technically feasible,”<sup>10</sup> with an exception. The Derivatives Committee proposed an exception to this time frame that would permit, but not require a reporting delay for block trades in order to provide protection for larger transactions.<sup>11</sup> In addition, under the post-trade transparency proposals, the Derivatives Committee recommended that DTFs provide certain “market information” to the general public.<sup>12</sup> However, the Derivatives Committee has not determined what this “market information” will be.

The Working Group notes that the public dissemination of post-trade information is permitted to be delayed, but there is no requirement that would prevent DTFs from disseminating this information in real-time. Further, depending on what would constitute “market information,” public dissemination of such information may hinder market participants’ ability to effectively hedge. With this in mind, the Working Group is concerned that the proposed post-trade transparency requirements are insufficient to protect counterparties to a transaction since they may not ensure that counterparties have adequate time to enter into any offsetting transaction that may be necessary to hedge their positions or otherwise fully execute their trading strategy.

**Solution.** The Working Group suggests that amendments be made to include a mandatory minimum time delay for public dissemination of data with respect to large trades. The Working Group also respectfully requests further guidance on what would qualify as “market information,” and cautions that depending on the scope of what would qualify as

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<sup>9</sup> As noted in Consultation Paper 92-401, “post-trade transparency” in the context of OTC derivatives refers to “the dissemination of price and volume information, other than to the executing parties, on completed transactions.” Consultation Paper 92-401 at 40.

<sup>10</sup> *Id.* at 41.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 41-42.

“market information,” a mandatory minimum time delay for public dissemination of such information may also be appropriate.

**G. The Proposed Approach Regarding Foreign-Based DTFs Should Be Amended.**

In Consultation Paper 92-401, the Derivatives Committee recognizes that “the Canadian OTC derivatives market comprises a relatively small share of the global market and a substantial portion of transactions entered into by Canadian market participants involve foreign counterparties.”<sup>13</sup> Given these realities, it is critical that the DTF regulatory framework does not impose unnecessary regulatory or economic burdens on foreign market participants, as this may cause them to exit the Canadian OTC derivatives market. In addition, it is critical that the DTF regulatory framework does not limit Canadian entities’ access to foreign derivatives markets. With this in mind, the Working Group is concerned about the approach contemplated in the proposals regarding foreign-based DTFs set forth in Consultation Paper 92-401.

Evidence of the cross-border consequences of a rigid trading facility framework and mandatory platform-execution paradigm can be seen in the global market for interest rate swaps. A recent study by the International Swaps and Derivatives Association (“ISDA”) found that after the CFTC’s SEF rules came into force, European dealers became reluctant to trade Euro-denominated interest rate swaps with U.S. counterparties.<sup>14</sup> That reluctance grew even more acute after the CFTC’s first mandatory trade execution requirements came into force.<sup>15</sup>

The absence of a streamlined framework for substituted compliance or equivalency determinations indicates that foreign-based DTFs may be subject to unnecessary economic and regulatory burdens if they provide access to Canadian entities. For example, Consultation Paper 92-401 contemplates that foreign-based DTFs could seek exemptions on a case-by-case basis if the foreign-based DTF is able to demonstrate to Canadian regulators that the regulation and oversight in its home jurisdiction is comparable.<sup>16</sup> Stated differently, each foreign-based DTF seeking an exemption would be required to demonstrate regulatory comparability of its home jurisdiction – even if another foreign-based DTF from the same home jurisdiction already successfully demonstrated the regulatory comparability. Not only would this impose unnecessary burdens, but it creates the potential for inconsistent determinations regarding comparability.

Further, Consultation Paper 92-401 proposes that foreign-based DTFs would still be subject to reporting obligations to Canadian securities regulators with respect to services

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<sup>13</sup> *Id.* at 3.

<sup>14</sup> See ISDA Research Note, *Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update* at 6 (July 24, 2014), available at <http://www2.isda.org/attachment/NjY0NQ==/Fragmentation%20study%20FINAL.pdf>.

<sup>15</sup> *Id.*

<sup>16</sup> See Consultation Paper at 46.

provided to local counterparties *even if its home jurisdiction is determined to be comparable*.<sup>17</sup> This duplicative reporting obligation may be unnecessary if Canadian regulators can arrange access to that information from the DTF's home country regulator.

**Solution.** The Working Group respectfully requests that the DTF regulatory framework includes a reasonable framework for substituted compliance or equivalency determinations and provides other necessary compliance relief in order to avoid imposing unnecessary burdens on foreign market participants.

### **III. CONCLUSION.**

The Working Group appreciates this opportunity to provide comments on Consultation Paper 92-401 and respectfully requests that the comments set forth herein are considered during the drafting process.

If you have any questions, please contact the undersigned.

Respectfully submitted,  
*/s/ R. Michael Sweeney, Jr.*  
R. Michael Sweeney, Jr.  
Alexander S. Holtan  
Blair Paige Scott

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<sup>17</sup>

*Id.*