



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

August 29, 2017

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

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Dear Sirs/Mesdames,

**Re: Pension Investment Association of Canada (“PIAC”) Comments on CSA  
Proposed National Instrument 93-101 – Derivatives: Business Conduct**

The Pension Investment Association of Canada (PIAC) would like to thank the CSA for considering our comments on Proposed National Instrument 93-101 – Derivatives: Business Conduct (the “Proposed Regulations”) and accompanying Companion Policy.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over \$1.8 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries. PIAC's positions on public policy reflect the fiduciary framework in which member funds operate and its commitment to work in the best interests of plan members.

PIAC is supportive of the CSA's efforts to introduce business conduct regulations on derivatives dealers and derivatives advisers. PIAC would like to comment on the following aspects of the Proposed Regulations:

- PIAC supports the fair dealing requirements within section 8, and specifically, PIAC believes that it is important that Canada's securities regulators have the regulatory tools necessary in order to bring enforcement against deceptive and manipulative trading practices or fraudulent activities by dealers.
- PIAC supports the requirements to disclose conflicts of interest (Section 9(3)) and would stress the importance that meaningful disclosure be specific and be provided shortly before a transaction takes place.
- PIAC is concerned with the inclusion of “Directly or indirectly carrying on the activity with repetition, regularity or continuity” and “Transacting with the intention of being compensated” as factors to be considered in determining whether a person or company meets the definition of “derivatives dealer” or “derivatives adviser”. These factors, as drafted, are overly broad and may inadvertently capture pension plans or their sponsors.
- PIAC is concerned that the investment-related services provided by pension plan sponsors to their sponsored plans, such as hiring third party investment managers, could be considered to be derivatives advice, and requests a specific exemption or guidance in the Companion Policy to address this outcome.
- PIAC is concerned with the proposal that would subject to derivatives advisers providing managed account services to eligible derivatives parties to all of the proposed business conduct requirements. Large and sophisticated pension plans do not need, or should be permitted to waive, business conduct requirements designed to protect retail investors.
- PIAC supports the proposed exemption for foreign derivatives advisers, given the importance for pension plans to access global expertise, however the proposed exemption is too narrow given that many jurisdictions do not subject derivatives advisers to a registration requirement.

- PIAC supports the proposed requirements for derivatives dealers and advisers to segregate client assets, however dealers and advisers must have some flexibility to use assets to appropriately collateralize or margin derivatives transactions.

Detailed discussion of each comment follows below.

## 1) Fair Dealing

PIAC supports the fair dealing requirements within Section 8 of the Proposed Regulations and the concept that a derivatives firm or individual acting on behalf of the firm must deal fairly, honestly, and in good faith with a derivatives party. We note that, because PIAC members act as administrators / trustees of or otherwise act on behalf of various pension plans / funds, it is of great concern to PIAC members that derivatives dealers deal fairly and in good faith, as improper activities on the part of dealer counterparties could have a direct impact on the retirement benefits of our members. Specifically, PIAC believes that it is important that Canada's securities regulators have the regulatory tools necessary to sanction dealers that engage in deceptive and manipulative trading practices or fraudulent activities. We have seen examples of these types of activities in foreign markets (FX Fixing or LIBOR market manipulation). We believe that the CSA should adopt fair dealing requirements that are similar to those in the United States, where derivatives business conduct rules in § 23.410 General Regulations under the Commodity Exchange Act of the Code of Federal Regulations, Title 17, Chapter I, state as follows:

- § 23.410 Prohibition on fraud, manipulation, and other abusive practices.
- (a) It shall be unlawful for a swap dealer or major swap participant -
- (1) To employ any device, scheme, or artifice to defraud any Special Entity or prospective customer who is a Special Entity;
  - (2) To engage in any transaction, practice, or course of business that operates as a fraud or deceit on any Special Entity or prospective customer who is a Special Entity;
- or
- (3) To engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.

PIAC notes that similar prohibitions against fraud, deceptive and manipulative trading practices in respect of OTC derivatives transactions appear to be included in Section 126.1 of the Ontario Securities Act, R.S.O., 1990, c. S.5, for example. It is important that similar prohibitions be included in the securities laws of each province and territory of Canada. PIAC believes that the "fair dealing" provisions in the Proposed Regulations should capture circumstances involving fraud, market manipulation or other abusive practices, however the CSA should also consider the specific inclusion of these practices within the Proposed Regulations (to the extent not already included in provincial securities legislation).

## 2) Disclosure of Conflicts of Interest

PIAC supports the requirements to disclose conflicts of interest (Section 9(3)) and would stress the importance that disclosure be specific and be provided shortly before a transaction takes place, and should not be met by a catch-all regulatory disclosure sent to

all clients well in advance of any affected transaction. We believe that there is little value in catch-all disclosure of conflicts of interest that are sent to clients well in advance of a trade (e.g., on an annual basis).

In the event that the revised Proposed Regulations incorporate the ability for conflicts of interest to be disclosed on an omnibus basis, PIAC recommends that these disclosures be separated into two categories: (i) general conflicts of interest disclosures applicable to all counterparties and (ii) disclosures specific to a counterparty or a specific contemplated transaction. PIAC views disclosures of general conflicts of interest to be those which affect all counterparties and transaction types, and which could potentially be addressed in a written general (potentially annual) disclosure of conflicts of interest. On the other hand, PIAC places more importance on specific disclosures of conflict of interest that are material and specific to a counterparty or a particular transaction. We believe that such disclosure should be provided shortly before a transaction takes place, and that it should be specific, clear and meaningful. For instance, a dealer could disclose the conflict to a trader of a counterparty over a taped line prior to trading, or send a written notice to the individual with the counterparty that is expected to enter into the transaction shortly before a transaction. We would also note that in some circumstances, it might be appropriate for a dealer to disclose a conflict after a transaction has taken place, for example, in the case of an equity total return swap where subsequent to entering into a transaction, a dealer becomes an M&A adviser in respect of the equity underlier (where the proposed M&A activity has been publicly announced) and also seeks to engage in further trades.

### **3) Derivatives Dealer and Adviser - carrying on the activity with repetition, regularity or continuity or transacting with the intention of being compensated**

PIAC is concerned with the inclusion within the Companion Policy of “Directly or indirectly carrying on the activity with repetition, regularity or continuity” and “Transacting with the intention of being compensated” as factors to be considered in determining whether a person or company meets the definition of “derivatives dealer” or “derivatives adviser”.

Pension plans, due to their size and mandate, might engage in various types of OTC derivatives transactions with repetition, regularity or continuity and may earn various forms of compensation, including cost recovery, for doing so, however, such plans and their sponsors do not act as a dealer (or adviser) in any traditional sense. For example, pension plans may hedge foreign currencies, which usually involves rolling multiple three month FX forward transactions with repetition and continuity. Moreover, pension plans might seek various OTC derivatives strategies in order to obtain broad market exposures (such as through the use of equity swaps).

Respectfully, the use of OTC derivatives by pension plans should not be indicative of the activities of a dealer, regardless of trading frequency or potential for compensation. Instead, we believe that the other factors articulated by the CSA in the Companion Policy to the Proposed Regulations, including acting as market maker, intermediating transactions, solicitation of trades and providing derivatives clearing services, are the hallmarks of what are generally regarded as dealer or adviser activities. We are concerned that the inclusion of the factors "Directly or indirectly carrying on derivatives trading activity with repetition,

regularity or continuity" and "Transacting with the intention of being compensated" has the potential to capture pension plans and their sponsors. In our view, frequent derivatives trading activity, whether or not any compensation (as broadly described in the Companion Policy) is received, in the absence of the other business purpose factors, should not constitute dealing or advising activities.

We acknowledge that Section 39 of the Proposed Regulations [Exemption for certain derivatives end-users] may be useful for a pension plan that engages in regular derivatives trading activity, but the exemption may be of limited utility for a pension plan that may, in the ordinary course of business, quote prices at which it would be willing to transact or for a pension sponsor that provide investment-related services to their sponsored plans. Large pension plans with internal trading functions may be excluded from the end-user exemption simply by quoting prices to dealer counterparties, even though those pension plans do not solicit trades, offer to make a market in a derivative or otherwise act as a derivatives dealer or adviser.

#### **4) Derivatives Adviser – Pension Plan Sponsors and Affiliates**

PIAC is concerned that the definition of "derivatives adviser" in the Proposed Regulations could be interpreted broadly to capture pension plan sponsors and their affiliates that are providing investment-related services to their sponsored plans. For instance, this could arise where plan sponsors and their affiliates are engaged in hiring, and providing investment guidelines to, third party investment managers. In this context, plan sponsors and their affiliates may be making asset allocation decisions and exercising discretion in selecting specific derivatives trading strategies, such as tactical asset allocation overlay and hedging programs. PIAC is concerned that these types of activities could trip the "business trigger" underlying the definition of "derivatives adviser" if the discretion exercised and the investment guidelines provided are broadly considered to be derivatives advice.

It is submitted that the factors listed in the Companion Policy for determining whether a party is in the business of advising in respect of derivatives are primarily focused on dealer activities and, as a result, there is ambiguity or a lack of clarity about when a person will be considered to be engaged in the business of advising others as to transacting in derivatives. Many of the factors in the Companion Policy, such as quoting prices and transacting with the intent of being compensated, are not relevant to advisers. Moreover, the one factor that references "engaging in activities similar to a derivatives adviser" is overly broad and could be interpreted to capture pension plan sponsors and their affiliates involved in pension plan investing, particularly if they are making decisions regarding asset allocation and providing investment guidelines to third party managers.

To address the above concerns, PIAC respectfully requests that the CSA provide a specific exemption or specific guidance in the Companion Policy that Canadian pension plan sponsors and their affiliates who are providing investment-related pension services, such as those described above, are exempt from the Proposed Regulations or otherwise are not engaging in the business of advising others as to transacting in derivatives for purposes of the Proposed Regulations.

## **5) Managed Account of an Eligible Derivatives Party (EDP)**

Although PIAC supports the fair dealing requirements and the requirements to disclose conflicts of interest that will apply to derivatives dealers and derivatives advisers under the Proposed Regulations, PIAC is concerned about the approach adopted in Section 7(3) of the Proposed Regulations which would subject derivatives advisers providing managed account services to Canadian pension plans to all of the proposed business conduct requirements of the Proposed Regulations, despite the fact that Canadian pension plans are EDPs under the Proposed Regulations. PIAC is concerned that Canadian pension plans will have greater difficulty securing the services of global investment management firms in respect of derivatives-related activities when those global firms will be subjected to a broad set of business conduct requirements that are more appropriately applicable to a retail investment advisory business.

PIAC submits that EDPs such as Canadian pension plans are sophisticated investors that should not be treated like non-EDPs solely because they have chosen to invest and obtain advisory services through a managed account arrangement. If the CSA considers it necessary to apply a different standard to firms providing managed account services to EDPs, then PIAC respectfully requests that the CSA at least provide an opportunity for EDPs such as Canadian pension plans to waive the protections under the Proposed Regulations that would not apply to EDPs outside of the managed account context.

## **6) Foreign Derivatives Adviser Exemption – Section 44**

PIAC supports the exemption in Section 44 of the Proposed Regulations for foreign derivatives advisers that meet certain criteria or conditions. However, PIAC submits that the exemption is overly narrow to the extent that it requires the foreign adviser to be registered in the foreign jurisdiction in which it maintains its head office or principal place of business (Section 44(3)(a)). PIAC submits that the exemption should be amended to include foreign advisers that are exempt from registration or are not required to be authorized as an adviser in their home jurisdiction. So long as foreign derivatives advisers are conducting business in a jurisdiction with a regulatory framework that meets international standards, it is submitted that the foreign derivatives advisers should be permitted to take advantage of the exemption in Section 44 even if they are not subject to a registration requirement in that foreign jurisdiction.

It is also noted that the exemption for foreign derivatives advisers in Section 44 is not available where the adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in "the jurisdiction". It is unclear why this condition is necessary and it is submitted that this may significantly restrict the ability of Canadian pension plans to secure the services of foreign derivatives advisers that are subscribers to derivatives trading marketplaces that are so designated or recognized.

## **7) Derivatives Party Assets (Part 4, Division 2)**

While PIAC supports the requirement in the Proposed Regulations that derivatives dealers and advisers segregate client assets from the dealer's or adviser's own assets, PIAC is

concerned that the requirements in Division 2 of Part 4 regarding the manner in which a derivatives firm must hold derivative party assets may give rise to unintended consequences for derivatives dealers and derivatives advisers serving Canadian pension plans. It is submitted that derivatives firms providing services to Canadian pension plans must have the flexibility to use the assets of Canadian pension plans to appropriately collateralize or margin derivatives transactions. PIAC requests that the CSA give due consideration to the requirements of this part of the Proposed Regulations so that derivatives firms within and outside Canada are not restricted in the manner in which they conduct their business in providing services to Canadian pension plans.

### **Seven PIAC Areas of Focus**

We would like to thank the CSA for considering the comments from PIAC on the Proposed Regulations and accompanying Companion Policy.

In summary, PIAC believes that: (1) it is important to have the regulatory tools necessary to sanction deceptive and manipulative trading practices, and fraudulent activities; (2) meaningful disclosures of conflicts of interest specific to a derivatives transaction should be required; (3) the business triggers factors of trading with regulatory or with the intention of compensation should be narrowed for determining whether a party is a derivatives dealer or adviser, (4) investment-related services provided by pension plan sponsors should not be derivatives adviser activity, (5) derivatives advisers should not be required to comply with the full set of business conduct requirements when providing managed account services to EDPs; (6) the conditions for reliance on the exemption for foreign derivatives advisers should be modified to include unregistered firms and (7) there must be flexibility in the requirements for treatment of client assets.

We trust our response has been helpful. Thank you for your attention and please do not hesitate to contact us if you have any questions or concerns.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Kevin Fahey". The signature is written in a cursive, flowing style.

Kevin Fahey  
Chair