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August 31, 2017

Alberta Securities Commission
British Columbia Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Nunavut Securities Office
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

comments@osc.gov.on.ca and consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators Notice and Request for Comment - Proposed National Instrument 93-101 – *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP - *Derivatives: Business Conduct*

The Portfolio Management Association of Canada (“**PMAC**”), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the Canadian Securities Administrators’ (“**CSA**”) Notice and Request for Comment - Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (“**NI 93-101**”) and Proposed Companion Policy 93-101CP - *Derivatives: Business Conduct* (the “**Consultation**”). Capitalized terms used in this letter but not defined here have the same meaning given to them in the Consultation.

OVERVIEW

PMAC represents investment management firms registered to do business in Canada as portfolio managers. PMAC [members](#) encompass both large and small firms managing total assets in excess of \$1.5 trillion for institutional and private client portfolios¹.

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. PMAC consistently supports measures that we feel elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole. We support the CSA’s aim to establish a robust investor protection regime that meets the International Organization of Securities Commissions’ (“**IOSCO**”) standards with respect to over-the-counter (“**OTC**”) derivatives.

PMAC’S APPROACH TO THIS CONSULTATION

PMAC supports the work of the CSA to ensure that all derivatives firms remain subject to certain minimum standards in relation to their business conduct towards both investors and

¹ For more information about PMAC and our mandate, please visit our website at: www.portfoliomanagement.org.

counterparties. We applaud the work of the CSA to develop and adopt a harmonized derivatives registration and business conduct regime across Canada. We believe that the establishment of a national regime is a positive step for industry, the Canadian economy, and investors. We note, however, that the Consultation is primarily focused on addressing policy issues arising from dealing activities and does not identify specific issues with respect to the activities of advisers, particularly portfolio managers, vis-à-vis derivatives. Therefore, PMAC does not see a compelling policy rationale for requiring separate market conduct rules for advisers with respect to derivatives.

PMAC does not believe that the Consultation, as it would apply to advisers, adequately accounts for the fiduciary obligations owed by advisers to their clients. Many of the specific requirements outlined in the Consultation are already addressed by the fiduciary duty owed by advisers to their clients and/or by the well-established and effective set of registration, proficiency and market conduct requirements advisers are already subject to under National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“**NI 31-103**”). We do not believe that investors or the Canadian capital markets would benefit from the CSA imposing duplicative requirements on advisers in the derivatives context.

As a result, in submitting our comments and recommendations with respect to this Consultation, PMAC has assumed that the soon-to-be-published consultation on the derivatives registration regime (the “**Derivatives Registration Instrument**”) will exempt firms and individuals who are registered under NI 31-103. We believe that the CSA’s laudable policy objectives of creating a uniform approach and protecting participants in the OTC derivatives markets from unfair, improper and fraudulent practices can be best achieved for advisers by leveraging NI 31-103 with some minor amendments and/or through granting substituted compliance.

The CSA have acknowledged that the Consultation proposes to introduce several requirements that are similar to existing market conduct rules in NI 31-103 which have been tailored to reflect the derivatives markets. PMAC strongly believes that minor modifications to NI 31-103 - including exemptions where appropriate - to set out a complete code of conduct for registrants would be the most effective way to regulate firms for the benefit of investors without unduly increasing the regulatory burden. PMAC also believes that additional articulation and explanation of the differences in the business conduct rules for derivatives and those set out more generally in NI 31-103 would assist stakeholders in evaluating the proposals in the Consultation.

Were the CSA to determine that existing registrants under NI 31-103 - specifically, those registered as portfolio managers - require additional proficiency or other regulations to engage in the business of advising in derivatives, we believe that such requirements should be introduced gradually and with sufficient time so as not to disrupt the existing qualifications of advisers who are currently employing derivatives for the benefit of their investors. PMAC looks forward to the opportunity to comment on the Derivatives Registration Instrument and we anticipate that several comments made with respect to this Consultation will require revision and/or further elaboration once we have reviewed the details of the registration regime.

PMAC supports the ongoing efforts of the CSA to identify opportunities to improve the investor-adviser relationship. We believe that the integrity of the client-registrant relationship is of crucial importance to confidence in the markets, a healthy economy and access to investment advice for all Canadians. PMAC is a strong believer in the importance and effectiveness of existing registration requirements and ongoing obligations. We believe that the current framework is very well considered and sufficiently principles-based so as to allow firms to responsibly discharge their duty of care toward clients while adopting innovative and effective business models and philosophies. Firms registered as portfolio managers under NI 31-103 have developed and continuously oversee finely-honed compliance regimes and adhere to the highest standard of conduct in the industry –

the fiduciary standard². Portfolio management firms embrace change that will improve protection, efficiency and outcomes for investors but are wary of changes that will unduly increase regulatory burden through the establishment of separate rules and standards of conduct when fairly straightforward and less burdensome amendments to NI 31-103 would accomplish the same policy objective.

SUMMARY OF PMAC'S KEY RECOMMENDATIONS

- 1) For firms registered in the adviser category, codify the necessary amendments to create a derivatives business conduct regime through minor amendments to NI 31-103 to allow registrants to leverage existing compliance frameworks and to avoid increasing the regulatory burden and compliance costs without a corresponding investor protection benefit.
- 2) Leverage the existing sophisticated client definition of "permitted client" in NI 31-103 instead of introducing the new concept of "eligible derivatives party" or "**EDP**" and allow individual permitted clients to benefit from the carve-outs from the requirements that the CSA is willing to extend to non-individual EDPs as set out in the Consultation.
- 3) Reconsider the practicality and usefulness of the proposed written representation regarding an EDP's knowledge and experience pertaining to derivatives. A bright-line test based on financial resources should instead be sufficient and would be consistent with the CSA's approach in National Instrument 45-106 – *Prospectus Exemptions* ("**NI 45-106**") with the "accredited investor" definition and in NI 31-103 with the "permitted client" definition. If such a bright line test is deemed insufficient in the derivatives context, provide greater clarity as to when a firm would not to rely on representations made by an EDP.
- 4) Allow managed account clients that are EDPs to be included in the same carve-outs from certain requirements and protections applicable to EDPs. Managed account clients benefit from the highest duty of care owed by advisers and they do not require or want the protections that the Consultation proposes they should receive.
- 5) Where possible, harmonize the Canadian OTC derivatives rules with global rules such as the Commodity Futures Trading Commission's ("**CFTC**") requirements under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* to reflect the importance of the global nature of the OTC derivatives market. Specifically, ensure that business conduct requirements applicable to firms dealing with EDPs avoid duplication and/or conflict with similar existing rules in other legislation. PMAC members are concerned that an unduly onerous regime in this respect may lead global derivatives dealers to exit the Canadian market, leading to potentially adverse impacts on liquidity and systemic risk as well as to negatively impacting investors' access to quality derivatives products.
- 6) The Consultation goes beyond the requirements regarding collateral set out in National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* ("**NI 94-102**"). Provide clarification regarding the intended application of the provisions relating to the segregation, use, holding and investment of derivatives party assets as these apply to a portfolio manager acting on behalf of a managed account client

² This duty is currently imposed by common law across Canada and, pursuant to CSA 33-404, a statutory fiduciary will be introduced across Canada for jurisdictions that do not currently have such a duty in their securities acts.

where the adviser has been contractually granted authority with respect to the investment and use of portfolio assets including, but not limited to, derivatives. Provide an explanation as to why the requirements for derivatives party assets set out in the Consultation are broader and more onerous than those in existing securities instruments.

- 7) PMAC looks forward to the opportunity to further assess and respond to these proposed requirements when the Derivatives Registration Instrument is published to ensure that our recommendation requesting greater flexibility for registered firms with respect to the senior derivatives manager requirements are workable. Provide an optional carve-out for firms registered under NI 31-103 from the senior derivatives manager requirements to allow the senior derivatives manager to be the CCO. We strongly believe that it would be most effective for registered firms to have the option and flexibility to leverage the existing role of the CCO under NI 31-103 to include derivatives matters as an extension of their obligations to monitor compliance with securities laws generally. This approach will, of course, depend on the scope of the required derivatives experience and proficiency requirements for CCOs.
- 8) Address concerns about how the CSA will treat foreign derivatives firms who are exempt from registration under equivalent foreign or domestic regulations but would nonetheless be required to be registered in Canada and to comply with the requirements proposed by the Consultation by virtue of tripping over the business trigger. Ensure that the international sub-adviser exemption set out in subsection 8.26.1 of NI 31-103 is included in the derivatives registration and business conduct regimes so that existing business relationships and access to investments for firms' clients will not be disrupted.

PMAC has addressed certain of the Consultation questions in further detail below. Specific questions from the Consultation are italicized.

Definition of "Eligible Derivatives Party"

Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

PMAC has significant concerns with respect to the proposed introduction of the term EDP. Similar to the concerns raised in our [submission on CSA Consultation Paper 33-404](#)³ – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward Their Clients ("CSA 33-404")*, PMAC does not believe that another definition and category of a sophisticated investor should be adopted. The CSA note that they have slightly modified the "permitted client" definition in NI 31-103 to reflect some unique aspects of the derivatives markets, however, we do not feel that these differences truly warrant the inclusion of yet another sophisticated client category which will increase complexity. For instance, registered charities fall under the permitted client definition but have been excluded from the definition of EDP. We further note that permitted clients of firms will have provided representations as to their status in existing contractual arrangements and that it would be disruptive and unduly onerous to require an amendment of such contracts to capture any new sophisticated investor definition.

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

³ Please see pages 10-11 of the linked submission.

Similar to our submission on the proposed adoption of the definition of “institutional client” in CSA 33-404, PMAC continues to believe that the various categories of individuals included in the definition of permitted client (as defined in NI 31-103) are sufficiently sophisticated or have sufficient financial resources to protect themselves and warrant a carve-out from certain requirements and protections proposed in the Consultation, and these exclusions should not only be afforded to non-individual permitted clients or, in the case of the Consultation, non-individual EDPs. The underlying concept that the attainment of a certain threshold of financial resources can serve as a stand-in for sophistication (and, consequently, warrant exemptions from certain disclosure and protection) should not change whether the financial resources have been accumulated by an entity or by an individual.

Alternative Definition of “Eligible Derivatives Party”

Please comment on whether it would be appropriate to use the definition of “institutional client” proposed in CSA 33-404 as the basis for the definition of EDP in the Consultation.

PMAC reiterates its concerns submitted in connection with CSA 33-404 regarding the proposed definition of “institutional client”. PMAC feels that the \$100 million asset threshold in this proposed definition is arbitrary and very high in the context of the Canadian securities and derivatives markets. As indicated above, we are of the view that the introduction of yet another category among the multiple definitions and monetary thresholds denoting various sophisticated client categories does not benefit investors or registrants. We do not believe that the increased complexity is supported by compelling policy reasons to require this new definition.

Knowledge and Experience Requirements in Clauses (m) and (n) of the Definition of EDP

Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product-type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

PMAC believes that it will be impractical for derivatives advisers and dealers to make the EDP determination and to manage relationships at the product level. PMAC does not believe that EDPs are any more or less vulnerable than permitted clients. As a result, EDPs should not be treated differently by requiring a representation from EDPs as to their knowledge and experience in the derivatives context. It would be appropriate for the CSA to omit the proposed requirement for a written representation as to an EDP’s knowledge and experience pertaining to derivatives. Members believe that this requirement, as currently stated, is too vague and, as a result, such confirmation would be difficult to obtain from investors. Furthermore, due to the vagueness of the requirement and the ambiguity as to what “knowledge and experience” actually means in various circumstances, firms who obtain such a representation may be concerned about their ability to rely on such a statement. Members suggest that a bright-line financial resources test to ascertain the client’s degree of knowledge, understanding, level of sophistication or ability to otherwise protect themselves through obtaining expert advice or through contractual negotiation, would be preferable. This approach would also be consistent with the CSA’s approach in other securities instruments, such as in NI 45-106 with the categories of “accredited investor” and in NI 31-103 with the categories of “permitted client”.

If it is determined by the CSA that a written representation will be required in NI 93-101, PMAC believes that the guidance in the CP to 93-101 as to when a firm is entitled to rely on a representation should be expanded to provide greater clarity. The requirement that firms ensure that the derivatives party is presented with the waiver in a clear and meaningful manner to ensure that the derivatives party understands the information presented and the significance of the protections being waived is vague. Stakeholders would benefit from additional specificity that takes into account the practicalities of giving and obtaining such waivers.

Two-tiered Approach to Requirements: EDPs versus All Derivatives Parties

Should the two-tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

PMAC generally agrees that a two-tiered approach to investor protection in the Consultation makes sense as it echoes the approach in NI 31-103 which treats permitted clients differently than retail clients and allows for a reduction in the regulatory burden where the end investor is deemed not to require certain disclosures and/or protections.

PMAC does have some specific concerns and questions about why derivatives advisers acting for a managed account of an EDP are not included in the carve-outs otherwise contemplated for EDPs. The requirements proposed in the Consultation for managed account clients that are EDPs would increase the regulatory burden and compliance costs without any meaningful enhancement to investor protection. Especially in light of the fiduciary duty owed by portfolio managers to their clients – and in light of the proposed introduction through CSA 33-404 of a statutory fiduciary duty for all registrants managing the investment portfolios of a client through discretionary authority granted by the client - we query the policy rationale for requiring such investors who are EDPs to be treated as non-EDPs simply by virtue of having a managed account.

Managed accounts are subject to the terms of an investment management agreement entered into between the investor and adviser. We believe that different treatment of managed account EDPs is unnecessary because managed account clients are often large and sophisticated institutions who neither want nor require such treatment. Managed account clients benefit from both the fiduciary obligation owed to them by their adviser as well as the contractual terms of the investment management agreement which suggests that they would require less protection than an EDP transacting directly with a dealer, not more. For example, managed account clients of portfolio managers would neither want nor require daily valuation reporting in respect of derivatives. These clients have elected to have their accounts managed by portfolio managers and, quite often, have bespoke reporting provided to them and have otherwise protected their interests through contractual negotiations. While we acknowledge that NI 31-103 does not extend certain exemptions (for example, KYC or suitability) to even the most sophisticated of permitted clients when they invest through managed accounts instead of through funds (for example, large pension plans), PMAC does not believe that such treatment of managed accounts is warranted under NI 31-103, nor should it be extended to the derivatives regime. We believe that the compliance costs associated with Section 7(3) of proposed NI 93-101 are not proportional to the benefits these sophisticated investors would receive.

Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

PMAC urges the CSA to ensure that the business conduct requirements for firms dealing with EDPs are consistent with already-existing requirements and avoid any duplication and/or conflict with existing rules. We understand that the rules in relation to tied-selling, fair terms and pricing, holding of assets, use and investment of assets and transaction confirmations, as currently proposed in the Consultation, are not harmonized with CFTC requirements. The CFTC rules have governed global market participants for a number of years and members are concerned that certain global derivatives dealers may choose to exit the Canadian OTC derivatives market rather than incurring the operational and compliance costs of implementing Canadian-specific requirements in this respect. PMAC members have voiced concerns about the negative impact this would have on liquidity and on systemic risk for Canadian market participants, including advisers and their clients.

Derivatives Party Assets

PMAC believes that Sections 26-28 of NI 93-101 - the provisions relating to the segregation, use, holding and investment of derivatives party assets– unnecessarily go beyond the requirements regarding collateral set out in NI 94-102. PMAC members have noted that, for advisers who have been granted authority to invest and use client assets (which may include derivatives but which will also include other types of assets), compliance with these Sections of NI 93-101 will be problematic. We believe that the CSA should provide greater clarity around how these Sections apply to the assets of clients of portfolio managers. Additionally, PMAC believes that the requirements for derivatives party assets set out in the Consultation are boarder and more onerous than those in existing securities instruments without an articulation of why this broader approach is required in the context of NI 93-101.

Senior Derivatives Managers

Please comment on the proposed senior manager requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

PMAC's comments with respect to the senior derivatives manager requirements will be impacted by the details in the Derivatives Registration Instrument and, among other things, will depend on the scope of the required derivatives experience and derivatives proficiency requirements for CCOs. PMAC looks forward to the opportunity to assess these proposed requirements when the Derivatives Registration Instrument is published to ensure that the request set out in this submission is workable for firms of all sizes.

We ask the CSA to provide an optional carve-out for firms registered under NI 31-103 from the senior derivatives manager requirements to allow the senior derivatives manager to be the CCO. A separate senior derivatives manager regime should not be mandated for firms registered as portfolio managers under NI 31-103. The rules with respect to senior derivatives managers appear to be codifying certain relief and guidance provided by the Autorité des marchés financiers (the "AMF") which sought to allow CCOs of firms to become registered with respect to derivatives in the absence of the required derivatives experience and proficiency required by the AMF, if such firms could instead appoint a responsible person whose roles are substantially similar to those of the proposed senior derivatives manager. While we appreciate that this approach can be a more efficient way to allow a firm to be registered to advise in derivatives, as opposed to requiring compliance professionals such as CCOs to acquire derivatives proficiency and expertise, PMAC is concerned that the mandatory creation of a separate stream of compliance requirements and reporting falling on a business person may, for some firms, be unworkable and unnecessarily complex and, in fact, inadvisable.

Instead, we strongly believe that it would be sufficient to allow for registered firms to have the flexibility to leverage the existing role of the CCO under NI 31-103 to include derivatives matters as an extension of their obligations to monitor compliance with securities laws generally. This approach will, of course, depend on the scope of the required derivatives experience and derivatives proficiency requirements for CCOs. PMAC looks forward to the opportunity to assess these proposed requirements when the Derivatives Registration Instrument is published to ensure that this proposal would be workable.

Requiring a separate certification and compliance regime with respect to derivatives would serve to unnecessarily complicate the compliance function within firms while ignoring the already established and effective systems, testing, and reporting already in place at such firms. The CCO is already tasked with monitoring compliance with applicable requirements related to securities matters and it would make sense to leverage the responsibilities, proficiency, experience and skills

of the CCO in this respect - with the assistance of a designated derivatives person to assist, should the firm so choose,- to monitor compliance with derivatives business conduct matters.

PMAC members raised a number of questions with respect to how firms can practically implement the proposed senior derivatives manager requirements, including how firms who have more than one department transacting in derivatives would assign and manage this responsibility. We understand that this will be the case for many firms who may have an individual in charge of foreign exchange working separately from a team dealing with other OTC derivatives. Conversely, the proposed requirements create challenges for firms where there is only one person transacting in derivatives being required to supervise him or herself. The CSA should seek to minimize the duplication of specific compliance reporting since the CCO is already tasked with these duties. Members also raised concerns about requiring business people who are not in a compliance role to certify compliance to the board of directors. We believe that a requirement to submit a report to the board instead of certifying to the board would be more appropriate and this would be consistent with the obligation on a CCO of a registered firm to submit a report, at least annually, to the board found in Section 5.2 of NI 31-103. Similarly, we believe that any reporting to the regulators should be the obligation of the CCO. We anticipate having further comments and potential alternative ways to satisfy the CSA's policy objectives in this respect once the Derivatives Registration Instrument has been published.

Foreign Derivatives Firms

PMAC members voiced concerns that the exemptions for foreign derivatives firms who are subject to and compliant with equivalent domestic or foreign regulations may ignore the realities of firms who are exempt from registration with the Securities and Exchange Commission in the U.S. (or equivalents elsewhere) but would nonetheless be required to register in Canada and comply with the requirements proposed by the Consultation by virtue tripping over the business trigger. PMAC will be looking to ensure that the international sub-advisor exemption under Section 8.26.1 of NI 31-103 will be extended to the registration of foreign sub-advisors in the derivatives registration and business conduct context to ensure that existing business relationships and access to investments for firm's clients will not be disrupted.

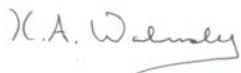
CONCLUDING COMMENTS

We would like to thank the CSA for the work, thought and outreach that has gone into developing and publishing this Consultation. We support the CSA's efforts in this respect and believe that Canadian investors and businesses are well-served by seeking to meet IOSCO's international standards for OTC derivatives. For registered advisers, we believe that this can be accomplished in a more efficient and effective manner by leveraging the existing market conduct rules and compliance framework in NI 31-103.

We would be happy to speak with you further about any of the remarks in our letter.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



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