Alternative Investment Management Association (AIMA)
The Forum for Hedge Funds, Managed Futures and Managed Currencies

Chairman
Gary Ostoich
Tel. (416) 601-3171

Deputy Chairman
Eamonn McConnell
Tel. (416) 669-0151

Legal Counsel
Michael Burns
Tel. (416) 865-7261

Treasurer
Chris Pitts
Tel. (416) 947-8964

Secretary
Andrew Doman
Tel. (416) 775-3641

Chief Operating Officer
James Burron
Tel. (416) 453-0111

www.aima-canada.org

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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903 Box 55
Toronto, Ontario M5H 3S8

c/o Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22 étage
C.P. 246, tour de la Bourse
Montreal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

Re: AIMA Canada's Comments on CSA Staff Consultation Paper 91-301 *Model Provincial Rules – Derivatives: Product Determination* and *Trade Repositories and Derivatives Data Reporting*

This letter is being written on behalf of the Canadian National Group (**"AIMA Canada"**) of the Alternative Investment Management Association (**"AIMA"**) and its members in relation to the Canadian Securities Administrators' (**"CSA"**) Staff Consultation Paper 91-301 *Model Provincial Rules – Derivatives: Product Determination* and *Trade Repositories and Derivatives Data Reporting* (the "**TR Rule**"). Our comments in this letter specifically address our concerns pertaining to the **TR Rule** provisions which relate to "proposed requirements for the operation and ongoing regulation of designated or recognized trade repositories and the reporting of derivative transactions by market participants."[1]

AIMA was established in 1990 as a direct result of the growing importance of

[1] Consultation Paper 91-301 at 2.

alternative investments in global investment management. AIMA is a not-for-profit international educational and research body that represents practitioners in hedge fund, futures fund and currency fund management – whether managing money or providing a service such as prime brokerage, administration, legal or accounting. AIMA's global membership comprises over 1,250 corporate member firms (with over 5,500 individual contacts) in more than 40 countries, including many leading investment managers, professional advisers and institutional investors. AIMA's Canadian national group, established in 2003, now has over 90 corporate members.

The principal aims of AIMA are to provide an interactive and professional forum for our membership and act as a catalyst for the industry's future development; to be the pre-eminent voice of the industry to the wider financial community, institutional investors, the media, regulators, governments and other policy makers; and to offer a centralized source of information on the industry's activities and influence, and to secure its place in the investment management community.

For more information about AIMA Canada and AIMA globally, please visit our web sites at www.aima-canada.org and www.aima.org.

This comment letter has been prepared by a working group of the members of AIMA Canada, comprised of managers of hedge funds and fund of funds, and accountancy and law firms with practices focused on the alternative investments sector.

Comments

AIMA Canada supports the purposes of the TR Rule, which are to improve transparency in the derivatives market and to ensure that trade repositories operate in a manner promoting the public interest.[2] However, we have significant concerns with the TR Rule as currently drafted.

Subsection 25(1): Redundancy in Data Reporting Caused by the Broad Definition of "Local Counterparty"

According to subsection 25(1), a local counterparty must, subject to certain exceptions, "report, or cause to be reported, to a designated trade repository, derivatives data for each transaction to which it is a counterparty."

"Local counterparty" is defined in very expansive terms and will capture a party if, at the time of the transaction, any of the following applies:

[2] *Ibid.*

The Alternative Investment Management Association – Canada
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Email**: info@aima-canada.org **Internet: www.aima-canada.org**

(a) the party is an individual who is a resident of [Province x],

(b) the party is a person or company, other than an individual, organized under the laws of [Province x] or that has its head office or principal place of business in [Province x],

(c) the party is a reporting issuer under the securities legislation of [Province x],

(d) the party is a registrant under the securities legislation of [Province x],

(e) the party negotiates, executes, settles, writes or clears any part of the transaction in [Province x],

(f) the party is a subsidiary of a person or company, or group of persons and companies, described in any of paragraphs (a) to (d).

Because any of the foregoing criteria triggers a duty to report, many scenarios exist which would require a report to be filed in multiple jurisdictions. This leads to the anomalous and likely unintended result of some transactions being reported in one jurisdiction while others are reported in multiple jurisdictions. The potential outcome of implementing the TR Rule with the proposed definition of "local counterparty" may in fact run counter to the proposed purpose of increasing transparency and regulating in the public interest. Simply, multiple reporting of the same transaction presents an inaccurate portrayal of market activity, which in turn hinders proper regulatory monitoring.

We propose that this unwieldy reporting patchwork is best avoided by having one centralized trade repository both as a designated trade repository and to collect data on behalf of all of the provinces and territories. Centralized trade repositories would have the additional benefit of standardizing the input and output of the trade repository's reported data. Alternatively, the TR Rule could be reformulated to allow for the paramountcy of a particular jurisdiction.

Paragraph 27(1)(b): Duplication of Data Reporting by Both Counterparties

Paragraph 27(1)(b) requires that if the counterparties cannot agree on who should report the transaction, then both counterparties must report. This would result in a duplication of the reporting of the trade as it is unlikely that the trade data will be identically reported by the counterparties. As discussed above, problems arise when one transaction is reported multiple times. A distorted representation of derivatives trading would emerge, which obfuscates true market activity and thereby foils the TR Rule's purpose.

We acknowledge that this issue can be avoided by the counterparties agreeing as to

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which party will report. However, reaching such an agreement may not be commercially viable in some circumstances. The determination of whether a trade will be reported once or twice (and thereby skewing market data) should not be dependent on how cooperative two counterparties are with each other.

Paragraph 27(2): An Undue Burden is Placed on Local Counterparties Transacting with Non-Local Counterparties

Paragraph 27(1)(a) sets out that "if the transaction is between a derivatives dealer and a counterparty that is not a derivatives dealer, the derivatives dealer is the reporting counterparty." Compelling justification exists for placing the duty to report on derivatives dealers. Derivatives dealers are well-positioned to report based on their expertise and logistical capacity. By contrast, it would be onerous for non-dealers, including AIMA Canada's members, to be required to report. As non-dealers they should not be subject to the operational costs of reporting derivatives transactions.

However, subsection 27(2) requires that in the event that a local counterparty's non-local counterparty does not comply with the reporting requirements, the local counterparty must comply with the reporting requirements. It is our submission that this places an undue burden on the local counterparty. This rule would lead to instances where sophisticated non-local derivatives dealers would be able to shift the duty of reporting onto local non-dealers.

Additionally, differential treatment of local non-dealer counterparties, depending on whether their counterparties are local or not, can have inadvertent detrimental market consequences. In an effort to avoid reporting requirements, local non-dealer counterparties may disproportionately favour local derivatives dealer counterparties over non-local derivatives dealer counterparties. Consequently, the diversification of derivatives dealer counterparties may be diminished by the decreased participation of non-local derivatives dealer counterparties. In fact, contrary to the CSA's intent, systemic risk may actually be increased as a result of a reduction of the number of active derivatives dealer counterparties.

Section 28: Real-Time Reporting is Impractical for Non-Dealer Counterparties

Subsection 28(1) requires real-time reporting unless it is not technologically practical to do so. Subsection 28(2) places an outside limit on reporting as the end of the next business day following the day of the transaction. We urge the CSA to recognize that some market participants, particularly non-dealer counterparties, would have difficulty in meeting this timing requirement. Generally, non-dealer counterparties do not have the infrastructure in place to report trading data in the time limit contemplated. Additionally, it is not economically feasible for many

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non-dealer counterparties to implement such infrastructure. We encourage the CSA to extend the reporting time limit for non-dealer counterparties to more accurately reflect the reality of their capabilities.

Section 31: Inapplicably in Situations Without a Designated Trade Repository

Section 31 requires that a designated trade repository must assign a unique transaction identifier to each transaction. This raises the concern of situations where a designated trade repository does not exist. As set out in the TR Rule, an application process is required before an entity can become a designated trade repository. This creates the possibility that there may be delays in the establishment of designated trade repositories, and that some jurisdictions may completely lack a designated trade repository. This issue buttresses our previously discussed recommendation of establishing one centralized trade repository for each type of transaction.

Subsection 39(3): Counterparty Trade Risks Should be Protected by a Mandatory Disclosure Delay

Subsection 39(3) has the stated objective of ensuring "that market participants have adequate time to enter into any offsetting transaction necessary to hedge their positions."[3] The objective is to allow counterparties to hedge risk before it becomes unduly difficult or expensive. The potential for market manipulation based on prematurely released data is particularly acute given the relatively limited number of Canadian market participants and corresponding liquidity level.

While we strongly support this objective, we respectfully submit that this objective is not achieved by the current drafting of subsection 39(3). The issue raised by the current drafting is that the delays of one or two days (depending on counterparty identity) are optional, rather than mandatory. The designated trade repository must disclose transaction level reports *not later* than one or two days after receipt from the reporting counterparty. As drafted, there is no requirement that the trade repository wait one or two days.

The stated objective of subsection 39(3) is better achieved by making the delays mandatory. It is our suggestion that subsection 39(3) should be revised to prevent transaction level reports from being publicly disclosed until one day after reporting. This would allow counterparties to protect their risks prior to their trading strategy being prematurely disclosed. We firmly believe that any harm the market would suffer as a result of the one day delay would be minuscule, and in any event would be far outweighed by the benefit of preventing market manipulation.

[3] *Supra* note 1, at 53.

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Conclusion

We appreciate the opportunity to provide the CSA with our views on the TR Rule. While supportive of its stated purpose, we have serious concerns above specific aspects of it. Please do not hesitate to contact the members of AIMA set out below with any comments or questions you might have. We would be happy to meet with you in order to discuss our comments further.

Gary Ostoich, Spartan Fund Management
Chair, AIMA Canada
(416) 601-3171
gostoich@spartanfunds.ca

Ian Pember, Hillsdale Investment Management Inc.
Co-Chair, Legal & Finance Committee, AIMA Canada
(416) 913-3920
ipember@hillsdaleinv.com

Dawn Scott, Torys LLP
Co-Chair, Legal & Finance Committee, AIMA Canada
(416) 865-7388
dscott@torys.com

Tim Baron, Davies Ward Phillips & Vineberg LLP
(416) 863-5539
tbaron@dwpv.com

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By:

Ian Pember
On behalf of AIMA Canada and the Legal & Finance Committee