March 9, 2017

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Dear Sirs/Mesdames:

Re: Autorité des marchés financiers (the "AMF") Request for Comments dated February 1, 2017 on Proposed Amendments to Derivatives Regulation (the "Amendments")

INTRODUCTION

The Canadian Market Infrastructure Committee ("**CMIC**")[1] welcomes the opportunity to comment on the Amendments.[2] In particular, CMIC wishes to comment on the proposed amendment to the Quebec Derivatives Regulation[3] to (1) add a reporting requirement in order to identify parties to OTC derivatives transactions that qualify as accredited counterparties solely because they are Hedgers[4] (the "**Identification Requirement**") under Division I.1, and (2) add a prohibition for individuals with respect to certain binary options.

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[1] CMIC was established in 2010, in response to a request from Canadian public authorities,[1] to represent the consolidated views of certain Canadian market participants on proposed regulatory and legislative changes in relation to over-the-counter ("**OTC**") derivatives. The members of CMIC who are responsible for this letter are: Alberta Investment Management Corporation, Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan Trust Fund, HSBC Bank Canada, Invesco Canada Ltd., JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Royal Bank of Canada, Sun Life Financial, The Bank of Nova Scotia and The Toronto-Dominion Bank. CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian over-the-counter ("**OTC**") derivatives market. The membership of CMIC has been intentionally designed to present the views of both the 'buy' side and the 'sell' side of the Canadian OTC derivatives market, including both domestic and foreign owned banks operating in Canada. As it has in all of its submissions, this letter reflects the consensus of views within CMIC's membership about the proper Canadian regulatory regime for the OTC derivatives market.

[2] See Notice and Request for Comments, available at: http://www.lautorite.qc.ca/files/pdf/reglementation/instruments-derives/reglements/instruments-derives/2017-02-01/2017fev01-rid-avis-cons-en.pdf; and Proposed Regulation to Amend the Derivatives Regulation, available at: http://www.lautorite.qc.ca/files/pdf/reglementation/instruments-derives/reglements/instruments-derives/2017-02-01/2017fev01-rid-cons-en.pdf.

[3] RRQ, 1981, c I-14.01, r.1, available at: http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=3&file=/I_14_01/I14_01R1_A.HTM

[4] That is, the counterparty is an "accredited counterparty" because they satisfy only section 3(12) (referred to as the hedger exemption branch) of the definition of "accredited counterparty" under the *Derivatives Act* (Quebec), and no other branch of that definition (such person, a "**Hedger**").

CMIC Recommendation re Hedger Exemption. CMIC understands that the AMF would like to receive information which identifies and quantifies the number of Hedgers in order to assess their status as accredited counterparties. Specifically, our understanding is that the AMF is concerned that derivatives dealers are entering into OTC derivatives with Hedgers who are unsophisticated and who may need additional protection by dealing with a registered derivatives dealer. We understand that one solution the AMF is considering is to remove the Hedger exemption. However, before doing so, we understand that the AMF wishes to know the impact of this on market participants. Accordingly, the AMF is proposing to implement the Identification Requirement.

CMIC understands the AMF's concern about unsophisticated counterparties entering into OTC derivatives. However, it is CMIC's view that removing the Hedger exemption would not be the best way to address this concern. The Hedger exemption is very useful to small and medium sized businesses that need to hedge their foreign currency or interest rate risks in respect of their commercial operations. For example, a large number of small, Quebec based companies tend to export goods and services to, or import supplies from, the USA as part of their business model. Such companies, regardless of their size, need to routinely hedge their foreign exchange risk. Hedging needs depend on, among other things, the location of a company's customers, its cash flow levels, and interest rate mismatches among its assets and liabilities; it is not correlated to the size of its balance sheet. Under this example, the only possibility for a company to hedge its risks is to maintain access to the OTC derivatives market since such market can provide bespoke products in order to exactly match the size and timing of the company's cash flows. No market other than the OTC derivatives market can provide such a tailored risk management solution.

In addition, CMIC cautions the AMF that the information received pursuant to the Amendments with respect to Hedgers may not present an accurate or a complete picture. The Amendments themselves will likely affect market behaviour, even before the Amendments become effective. Although CMIC has proposed some recommendations below, even if the recommendations are accepted, there may be financial institutions and derivatives dealers which determine that maintaining Hedgers as OTC derivatives clients is not worth the additional burden the Identification Requirement imposes. Accordingly, the data received by the AMF pursuant to the Identification Requirement may likely not be an accurate representation of Quebec counterparties that rely on the Hedger exemption.

Given that the vast majority of derivatives dealers and financial institutions will only trade with accredited counterparties, deleting the Hedger exemption will only exclude small and medium sized businesses from the OTC derivatives market, thereby increasing risks for such businesses. CMIC submits that the Hedger exemption should remain, but should be amended to define a Hedger as a person who is hedging commercial risk.[5] We believe this to be consistent with defining a hedger in other jurisdictions. By way of example, the definition of an "eligible contract participant" under Dodd-Frank includes an entity who is hedging its commercial risk.[6] CMIC fully supports adopting a similar approach to defining a Hedger under the Derivatives Act except that a threshold of $1 million would

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[5] High net worth individuals should not require a Hedger exemption as they would qualify under the $5 million minimum asset threshold in subparagraph 3(7)(b) of the Derivatives Act and section 1 of the Derivatives Regulation.

[6] Section 1a(18)(A)(v)(III) of the Commodity Exchange Act provides that a corporation, partnership, proprietorship, organization, trust or other entity that has a net worth exceeding USD 1 million and enters into a transaction in connection with the conduct of the entity`s business or to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred by the entity in the conduct of the entity`s business is an eligible contract participant. Available at https://www.sec.gov/rules/concept/2010/34-62717.pdf, page 23. In addition, it is CMIC's understanding that the Commodity Exchange Act (CEA) prohibits off-exchange foreign exchange transactions with counterparties that do not qualify as "eligible contract participants" (ECPs), referred to as Retail Forex Transactions, unless certain registration and other regulatory requirements are met. However. Retail Forex Transactions do not include spot fx transactions or transactions that require delivery of currency between two parties acting in accordance with their line of business. This is broader than the above USD 1 million threshold. See CEA § 2(c)(2)(C)(i)(II)(bb)(BB), 7 U.S.C. § 2(c)(2)(C)(i)(II). Available at: https://www.law.cornell.edu/uscode/text/7/2.

be too high for legitimate Quebec Hedgers. We believe this proposed solution would limit the ability of unsophisticated Hedgers to rely on this exemption while avoiding burdensome reporting requirements in relation to existing legitimate Hedgers.

Identification Requirement is Burdensome. Although CMIC understands the AMF's purpose behind proposing the Identification Requirement, in CMIC's view, the proposed Identification Requirement would be overly burdensome particularly having regard to the purpose the proposed regulation is seeking to achieve. The obligation to provide a report with Hedger information will generally rest with financial institutions and broker dealers entering into transactions with Hedgers. However, the financial institution members of CMIC are either unable to identify Hedgers, or the task of identifying the Hedgers is, in CMIC's view, disproportionately burdensome to the purpose the proposed regulation is seeking to achieve. In terms of their dealings with Hedgers in Quebec, all financial institution members of CMIC fall within one of the three following categories, (i) some financial institutions have simply asked each of their Quebec counterparties whether it is an "accredited counterparty" without asking which specific branch or branches of the definition apply, and accordingly would not be able to identify Hedgers without a client outreach, (ii) some financial institutions only ask each of their Quebec counterparties whether it is a "hedger" because those financial institutions will only deal with counterparties who are hedging, regardless of how many assets they have and therefore, those financial institutions are unable to determine, without a client outreach, whether those hedgers also satisfy another branch of the definition of "accredited counterparty", and (iii) some financial institutions obtain a specific representation from its Quebec counterparties which identifies all the ways in which that counterparty is an "accredited counterparty",[7] however, that information is not recorded in an easily traceable system and the only way to identify which counterparties are Hedgers would be to manually review every ISDA Agreement or separate representation. As a result, it is very clear that an outreach would be required to identify clients who only meet the hedger exemption and no other category of the definition of "accredited counterparty".

We do not believe that a massive client outreach will solve this. The experience with Canadian derivatives trade reporting requirements has been that financial institutions were at the forefront of client education on derivatives reporting issues, absorbing much of the cost for the broader market. While the vast majority of these Hedgers are small to medium corporate entities, based on prior experience, they are generally not responsive to requests from financial institutions for additional information. The accumulation of costs and time-spent pursuing a client to obtain Hedger representations will impede the ability of financial institutions to serve their clients' hedging needs. In addition, we note that it may be difficult for financial institutions to identify Quebec counterparties who have not indicated that they are a "local counterparty" in Quebec. Thus, the client outreach efforts will not be limited to Quebec clients but would require a broader outreach to all of the financial institution's clients that have not confirmed their jurisdiction.

CMIC Recommendations re Identification Requirement. The Identification Requirement commences once the Amendments come into force. Each transaction entered into thereafter with a Hedger is subject to the additional reporting requirement. CMIC submits that a six month transition period (the "**Transition Period**") is necessary such that the additional reporting requirement commences in respect of transactions with Hedgers entered into after the Transition Period. In addition, due to the reasons set out above, financial institutions are unable to determine with certainty (or, in the case of some financial institutions, they are unable to determine without a significant amount of work and costs) which of their existing clients are Hedgers. Therefore, CMIC recommends that, with respect to existing clients only, financial institutions would be expressly permitted to use commercially reasonable efforts in order to determine whether an existing client who enters into a transaction after the Transition Period is likely a Hedger. The amended regulation or companion policy should

[7] For this category, we note that a client may have indicated that it is a Hedger because it met the Hedger criteria even though the client may also be an "accredited counterparty" under another category of that definition.

expressly identify what would constitute commercially reasonable efforts and the AMF`s proposal in this regard should be subject to further public consultation. CMIC submits that such commercially reasonable efforts would include looking at the types of clients within certain areas of a financial institution and based on that, assess, based on facts reasonably available to that financial institution, whether those types of clients could typically fall into the category of Hedgers. For example, a financial institution's retail and commercial areas generally have counterparties to OTC derivatives transactions that are smaller or medium sized clients or individuals, whereas a financial institution's capital markets clients generally have assets in excess of $10 million. Based on that example, a financial institution should be considered to have used commercially reasonable efforts to identify Hedgers if it then decides to identify only its retail and commercial clients and not its capital markets clients as Hedgers (without conducting a review of representations or a client outreach). There may also be situations where a financial institution conducts a general review of its retail and commercial areas and determines that it generally does not transact with Hedgers. In some cases, this may mean that financial institutions may inadvertently miss identifying a Hedger. In other cases, this may mean identifying some clients as Hedgers when those clients also fall under another branch of the definition of "accredited counterparty". Such under or over reporting should expressly be permitted in the rule in order to prevent additional privacy law concerns.[8]

For new clients, i.e. clients who are on-boarded to a financial institution after the Transition Period, financial institutions will be able to identify whether that client is a Hedger and therefore commercially reasonable efforts are not required. However, the Transition Period is required in order for the financial institutions to change their onboarding processes with respect to Quebec counterparties in order to identify Hedgers.

If the AMF does not adopt the above recommendations, some financial institutions have indicated that they would not be able to comply with the Identification Requirement and therefore they may decide to stop transacting with Hedgers after the effective date of the Amendments. This will reduce overall liquidity for small and medium-sized end-users in Quebec having to cope with more limited access to hedging and less favourable pricing conditions.

Given that the stated purpose is to identify Quebec counterparties who are Hedgers in order to decide whether to keep the Hedger exemption, CMIC recommends that the AMF requires this additional reporting only for a finite period of time, for example, two years. CMIC submits that the information obtained during this time should be sufficient for the AMF. In addition, any changes to the Hedger exemption should be harmonized with the other provinces and with the new derivatives dealer registration rules to be published by the Canadian Securities Administrators. As these will be published later this year and expected to be finalized next year, it is CMIC`s view that this information regarding Hedgers should not be required by the AMF beyond two years.

Type of information requested. The Identification Requirement provides that financial institutions would be required to report the UTI of each transaction entered into, as well as LEI of each Hedger or, if the Hedger is an individual, the name, address and alternate identifier used by the financial institution. CMIC submits that the type of information to be reported should not include the names or addresses of individuals nor the UTI's of transactions, and should instead be limited only to the LEI or, if no LEI, the financial institution's alternative identifier, of a Hedger. Such reporting shall be required only once by a financial institution, regardless of how many transactions such Hedger enters into after the proposed Transition Period. All OTC derivatives entered into by the Hedgers are already reported, and if the AMF has the LEI or alternative identifier of the Hedger, the AMF can access the trading information of such Hedger pursuant to Regulation 91-507 respecting Trade Repositories and Derivatives Data Reporting ("**Regulation 91-507**"). It is CMIC's view that the accredited

[8] If the law does not expressly recognize the possibility of over reporting when using commercially reasonable efforts, financial institutions may be prevented from using such commercially reasonable efforts if it raises privacy law concerns.

counterparties responsible for this reporting should not be burdened with the requirement to also report UTI's when those are already available to the AMF pursuant to Regulation 91-507.

Binary Options Prohibition. With respect to Division I.2 of the Amendments, it is not clear, as currently drafted, whether a prohibited transaction must have all three characteristics set out in Sections 1.3(1), (2) and (3), or whether only one of the three characteristics is required. It is CMIC's understanding that all three characteristics should apply, and therefore we submit that the word "and" should be inserted at the end of Section 1.3(2). In addition, with respect to Section 1.3(2), CMIC understands that the words "the holder cannot buy or sell the underlying interest" is meant to refer to the fact that the transaction must be cash-settled. In CMIC's view, Section 1.3(2) should expressly refer to cash-settlement in order to avoid confusion. CMIC would also suggest adding language to clarify that this prohibition does not apply to exchange-traded transactions.

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CMIC welcomes the opportunity to discuss this response with you. The views expressed in this letter are the views of the following members of CMIC:

Alberta Investment Management Corporation
Bank of America Merrill Lynch
Bank of Montreal
Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Invesco Canada Ltd.
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank