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June 18, 2012

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Ontario Securities Commission
Saskatchewan Financial Services Commission

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Dear Sirs/Mesdames:

RE: CSA Consultation Paper 91-405 – Derivatives: End-User Exemption

We are writing in respect of Consultation Paper (Consultation Paper) 91-405 published by the Derivatives Committee of the Canadian Securities Administrators (CSA) regarding an end-user exemption for the Over the Counter (OTC) derivatives market. IGM Financial Inc. (IGM) is a diversified financial services provider which operates through its business units Investors Group Inc., Mackenzie Inc. and Investment Planning Counsel Inc. and their respective subsidiaries. Principal subsidiaries include registered portfolio managers I.G. Investment Management, Ltd. and Mackenzie Financial Corporation, and mutual fund dealer Investors Group Financial Services Inc. IGM is interested in this proposal as a number of its

subsidiaries use OTC derivatives for the hedging of commercial risks for their own account, or on behalf of investment funds and other client accounts that they manage.

We are supportive of the objectives of this initiative to regulate the OTC derivatives market as outlined within *Over-the-Counter-Derivatives Regulation in Canada* (Consultation Paper 91-401), and are further supportive of an end-user exemption from certain proposed regulatory requirements which would be available to market participants in situations where:

- a. Increased regulatory requirements could make it cost prohibitive and burdensome for end-users to use OTC derivatives to hedge or otherwise mitigate business risks, and
- b. The objective of reducing systemic risk is not advanced by imposing new regulatory requirements on end-users.

General Comments

We have two general comments that we would make at the outset regarding this proposal:

1. Financial institutions, which is not a defined term in the paper, should not be precluded from being able to rely on the end user exemption on a blanket basis. Instead a more nuanced approach should be adopted that excludes those financial firms that do not pose a systemic risk.
2. Canadian prospectus qualified mutual funds, and their managers to the extent of their involvement in managing those funds, should be excluded from the definition “financial institution”, since they are already subject to a comprehensive regulatory regime regarding their use of derivatives (both exchange traded and OTC).

Responses to Specific Questions

Dealing with the specific questions raised in the Consultation Paper, we would respond as follows (for ease of reference we have repeated the question before setting out our response):

Q1: Do reporting obligations create any barriers to participation in the derivatives market that would be unique to end-users or a category of end users? Please provide a description of the potential issues that end-users may face.

We are supportive of the mandatory requirement proposed for trade reporting by all market participants, including those market participants who elect to rely upon the proposed exemption. We would encourage any efforts to coordinate these reporting requirements with other reporting requirements of market participants where possible to mitigate costs or administrative burden.

Q2 & Q3: Are the end-user eligibility criteria proposed by the Committee appropriate, and should alternate additional criteria be considered?

We have a number of observations concerning the eligibility criteria proposed by the Committee:

- a. Definition of “financial institution or a firm acting in a capacity similar to a financial institution.”

One of the specified eligibility criteria is that an end-user be someone other than “a financial institution or a firm acting in a capacity similar to a financial institution”. We understand the importance of ensuring that systemic risk is appropriately addressed through regulation, and a restriction upon financial institutions relying upon the proposed end-user exemption seems consistent with this objective. However, we would note that “financial institution” has not been defined and, while the possibility of an exemption to small financial institutions has been considered within this comment paper, there has not been any specific guidance provided around how narrow or broad the definition of financial institution might be.

There are a diverse range of financial service activities performed by firms active in the Canadian marketplace¹ and there are different systemic risk considerations associated with different types of financial service providers. For instance, a default by a deposit-taking institution may, by its nature, have a different impact on the financial system than a default by a mutual fund manager on its own corporate obligations.² In other words, the potential impact upon depositors in the case of a bank default (and the potential related risks to the financial system) is quite different from the impact to mutual fund unitholders that might result from a mutual fund manager defaulting on its own corporate obligations.

Much like the potential for an end-user exemption for small financial institutions that was discussed in this Consultation Paper, we would encourage the development of a definition of “financial institution or other market participant acting in a capacity similar to a financial institution” that would permit application of the end-user exemption for a firm engaged in the financial services industry should the nature of its activities not pose meaningful systemic risk concerns. We believe that registered portfolio managers may be one type of financial services provider that warrants this consideration.

¹ The major types of these institutions and the regulatory regimes that govern them are summarized in section 6.2 of Consultation Paper 91-401.

² The assets under management of a mutual fund trust or corporation are held separately from the fund manager with an independent and qualified custodian, the fund manager is regulated, and the management of such funds can be transferred to another market participant in an orderly fashion if a problem arises.

Absent any specific systemic concerns relating to the activities of a particular kind of financial services provider, it may be more appropriate to grant an end-user exemption to a financial service provider (relative to other types of market participants) given that the financial service provider may already otherwise be subject to capital adequacy and other regulatory requirements.

- b. Potential for exclusion from certain specific regulatory requirements in absence of end-user exemption eligibility.

To the extent that the contemplated end-user exemption is not available to financial institutions, we would encourage the development of exemptions from certain proposed regulations³, and in particular those concerning clearing, margin, capital and collateral, for different financial service providers having regard to:

- the nature and extent of systemic risk posed by the firm or the activities performed by the firm,
- the nature of capital adequacy and other regulatory capital requirements to which the firm is already subjected,
- the nature and adequacy of credit management practices already engaged in by such firm and its derivative counterparties in relation to bi-lateral arrangements, and
- the cost and burden to these firms that proposed regulation may introduce to hedging or otherwise mitigating business risks.

One particular cost often cited by participants using derivatives to hedge commercial risks relates to collateral requirements. In particular, the timing mismatch associated with posting collateral in relation to derivatives used for hedging in a situation where the exposure being hedged does not provide offsetting liquidity (ie. where cash inflows from the exposure being hedged occur in the future).⁴ As opposed to accessing short term credit to bridge these resultant timing mismatches, market participants who use derivatives for hedging purposes may benefit by conducting hedging activities with a bank as derivative counterparty, with credit exposure of the

³ We note that the Consultative Paper 91-405 indicates “Although the end-user exemption would not be available to a financial institution, it is possible that some financial institutions may not be required to meet all of the proposed regulatory requirements” and “The Committee is prepared to consider specific exclusions from specific regulatory requirements if there is a valid public policy rationale for the exclusion..... A market participant that does not qualify to rely on the end-user exemption should review other consultation papers to determine whether another exemption may be available.”.

⁴ See *Market Review of OTC Derivative Bilateral Collateralization Practices*, International Swaps and Derivatives Association, Inc., March 1, 2010, p33.

bank to such market participant managed in the context of the broader credit relationship between the firms.⁵

We look forward to reviewing the forthcoming consultative papers relating to registration, clearing, capital and collateral.

- c. Considerations pertaining to Canadian prospectus-qualified investment funds and fund managers.

We would encourage that Canadian prospectus-qualified investment funds be considered appropriately in relation to the proposed regulations, namely:

- Coordination of any proposed regulations concerning margin, capital and collateral within the existing regulatory regime. There already exist registration requirements for mutual fund managers as well as “cash cover” and other requirements concerning derivatives use which serve to address any systemic risk considerations concerning i) a mutual fund’s ability to meet derivative-related obligations, and ii) the concentration of OTC Derivatives within a fund.
- Mutual funds should be excluded from the definition of “financial institutions” as relates to this end-user exemption and should instead continue to be governed by the comprehensive rules already in place in National Instrument 81-102 *Mutual Funds* concerning derivatives use.
- No margin, capital or collateral requirements should apply to the fund manager (as opposed to the unit trusts, limited partnerships or corporations that house the investment funds it manages) as a result of OTC derivatives engaged in by the fund manager on behalf of the funds.
- Should portfolio managers be excluded from the definition of “financial institution” for the purpose meeting the eligibility requirements of this end-user exemption (as we propose in a, above), activities performed by the portfolio manager on behalf of the funds should not preclude the portfolio manager from relying upon the end-user exemption as pertains to OTC derivatives use done for its own account to hedge its own commercial risks (recognizing that registration requirements for the portfolio manager may be required relating to OTC derivatives use on behalf of the funds).

⁵ As indicated within the Comment Paper, an end-user exemption does not preclude counterparties to derivatives contracts requiring collateral to support these contracts, and there is significant use of collateral in the OTC derivatives market today absent any mandatory requirements. Canadian banks are OSFI- regulated and subject to a number of requirements concerning credit and derivatives exposures.

d. Scope of derivatives use eligible for end-user exemption.

We agree with the definition of “hedging to mitigate commercial risks related to a market participant’s business” proposed within the paper, and its focus on the overall intent and effect of trading activity as opposed to an accounting definition. However, we believe that there are other types of derivatives use that, while not specifically engaged in for hedging purposes, may appropriately be considered consistent with meeting the criteria for this proposed end-user exemption.

A stated rationale in establishing this eligibility criteria for the end-user exemption (derivatives use only for hedging purposes) was to exclude from the end-user exemption those market participants who are in the business of trading derivatives or who speculate or otherwise trade to generate profit.

There are instances where firms may enter into OTC derivatives for commercial reasons other than those outlined above (hedging, speculating or conducting a trading business). For instance, it is common in a number of industries to use securitization as a financing vehicle for different types of property. As part of these securitization arrangements, a seller of property may enter into a “seller swap” whereby the seller retains certain elements of continuing involvement in the risks and returns of the transferred property.⁶

In our view, there are instances where this type of derivatives use for the purpose of facilitating a financing arrangement where a commercial exposure is retained by a market participant should not preclude a market participant from relying upon the end-user exemption. Considerations should include the cost and administrative burden of proposed regulation on the market participant, the systemic risk posed by the market participant, and the nature of the transferred asset and financing arrangement.

Q4. Are the Committee’s recommendations to exclude the specified end-user eligibility criteria from consideration appropriate?

The Committee considered other possible eligibility criteria, including i) volume or notional dollar values of trades, ii) sector specific exemptions (including small financial institutions), and iii) restrictions around using end-user exemption in instances where standardized contracts and clearing are available.

We encourage the use of the proposed trade repository to facilitate further assessment of an end-user exemption based upon the magnitude and nature of OTC derivatives trading

⁶ Under International Financial Reporting Standards, in many instances these derivatives are not accounted for as derivatives under IAS 39 *Financial Instruments* as the transfer of assets fails derecognition criteria and the transferor of the assets continues to record the transferred asset on its balance sheet instead of recording the derivative.

engaged in by a participant, the sector a participant engages in (including small financial institutions), or any other potential exemptions that would be consistent with the stated objectives of this end-user exemption.

In considering other potential exemptions, we would also encourage an active dialogue with specific market participants to understand the nature of derivatives use, the leverage inherent in positions and the credit management practices already in place by participants, recognizing that,

- An exemption based solely on volume or notional dollar value of trades may be prejudicial to firms that have a greater notional dollar value in derivatives, but which have less leverage inherent in their activities as a result of having offsetting positions or positions that are otherwise less sensitive to changes in underlying variables. Notional dollar value of trades is insufficient to gauge the counterparty credit exposure presented or taken on by a market participant.
- Existing practices concerning counterparty credit risk management may be sufficient to address systemic risk issues without imposing any additional requirements that may have inordinate or unintended adverse consequences to an end-user engaged in derivatives for hedging purposes.

Q5. Is the Committee's proposal that the market participant itself determine its qualification for an exemption and provide notice to the regulator of its intention to rely on the exemption appropriate?

We support the Committee's proposal.

Q6. Is the proposed process to be followed by eligible end-users wishing to rely on the exemption appropriate?

We support the Committee's proposal.

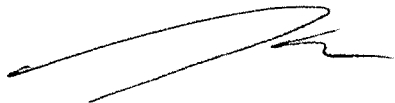
Q7. Is the Committee's proposal to require board of directors' approval of the use of OTC derivatives as a risk management tool to demonstrate hedging compliance appropriate for non-registrant entities?

We support the Committee's proposal, subject to our comments above concerning potentially broadening the scope of derivatives use that qualifies for the proposed end-user exemption.

We appreciate having this opportunity to share our views regarding the Consultation Paper and would be pleased to discuss any of these concerns with you at your convenience. If you would like to do so, please either contact myself or David Cheop at (204)956-8444 or david.cheop@investorsgroup.com.

Yours truly,

IGM FINANCIAL INC.

A handwritten signature in black ink, appearing to read 'Kevin Regan', with a stylized flourish at the end.

Kevin Regan, FCA, CFP
Executive Vice-President and Chief Financial Officer