Canadian Market
Infrastructure Committee

February 13, 2016

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: Autorité des marchés financiers (the "AMF") Request for Comments dated January 14, 2016 on Proposed Amendments to Derivatives Regulation and related Policy Statement respecting Accredited Counterparties (the "Amendments")

INTRODUCTION

The Canadian Market Infrastructure Committee ("**CMIC**")[1] welcomes the opportunity to comment on the Amendments,[2] in particular, the proposed amendment to the Quebec Derivatives Regulation[3] to add a new hedger certification requirement (the "**Certification Requirement**") under section 1.1.

If the Certification Requirement is adopted, in CMIC's view, the cost and complexity of completing these certifications may lead certain end-users of derivatives to abandon beneficial risk mitigating hedging. Further, the burden of ensuring that such certifications are completed will fall on financial institutions, despite their long history of serving the hedging needs of commercial clients in Quebec without incident. Compliance costs associated with financial institutions' enforcement of this new requirement would be passed along to end-users. The end-result is likely to be less risk mitigation for

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[1] CMIC was established in 2010, in response to a request from Canadian public authorities, to represent the consolidated views of certain Canadian market participants on proposed regulatory changes in relation to over-the-counter ("**OTC**") derivatives. The members of CMIC who are responsible for this letter are: Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ (Canada), Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Citigroup Global Markets Inc., Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan, HSBC Bank Canada, JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Public Sector Pension Investment 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 Comment available at: http://lautorite.qc.ca/files/pdf/reglementation/instruments-derives/reglements/instruments-derives/2016-01-14/2016jan14-rid-avis-consultation-en.pdf; see Proposed Regulation to Amend the Derivatives Regulation available at: http://lautorite.qc.ca/files/pdf/reglementation/instruments-derives/reglements/instruments-derives/2016-01-14/2016jan14-rid-cons-en.pdf; see Proposed Amendment to Policy Statement respecting Accredited Counterparties available at: https://www.lautorite.qc.ca/files/pdf/reglementation/instruments-derives/instructions-generales/contreparties/2016-01-14/2016jan14-ig-contreparties-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

commercial clients in the Quebec market, whereas the intent of the AMF's proposals is to promote well-functioning derivatives markets.

In the vast majority of cases, Quebec counterparties to financial institutions who rely on the "hedger" branch of the definition of "accredited counterparty" under the *Derivatives Act* (Quebec) (the "**Hedger Exemption**") are small to medium corporate entities, not individual counterparties. While the proposed Amendments provide that the obligation to deliver a hedging certificate falls on the hedger, financial institutions will need to ensure that their hedger counterparties have satisfied this requirement. Accordingly, resources will need to be deployed by financial institutions to communicate this new requirement, educate their hedger counterparties concerning these requirements, and implement ongoing operational procedures, for instance, to obtain representations regarding compliance by such hedger counterparties while, as accredited counterparties to such hedger counterparties, financial institutions already must routinely determine, over and beyond a hedger counterparty certification, if transactions with hedger counterparties indeed benefit from the exemption set out in section 7 of the *Derivatives Act* (Quebec)[4]. 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 hedger counterparties 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 new certification requirement will impede financial institutions' ability to serve their clients' hedging needs. At the extreme, some financial institutions may exit the Quebec derivatives market as a result of the above, reducing overall liquidity for small and medium-sized end-users.

CMIC understands that the AMF's purpose in proposing the Certification Requirement is to better determine the identity, number and quality of counterparties that are solely relying on the Hedger Exemption. We understand that the AMF is concerned that certain entities that are not registered derivatives dealers are entering into derivatives transactions with small retail counterparties, including individuals, who may not be aware that they need to qualify as an "accredited counterparty" under the Derivatives Act (Quebec). As a result, we understand the AMF is concerned that such retail counterparties do not qualify for the Hedger Exemption (or as an accredited counterparty under any other part of that definition) and therefore, in order to engage in derivatives transactions with such retail counterparties, such entities would have to register as dealers under the Derivatives Act (Quebec).

Based on the above understanding, CMIC submits that financial institutions are not the type of entity facing such small retail counterparties about which the AMF is concerned. Financial institutions have a long history of serving commercial Quebec market participants for the purpose of helping them meet their hedging needs. Therefore, CMIC recommends that the Certification Requirement should not apply to hedgers entering into derivatives transactions in reliance on the Hedger Exemption if their counterparty to the transaction is a financial institution, whether domestic or foreign (the "**Financial Institution Exemption**"). Financial institutions are already regulated and abide by long-standing best market practices of dealing derivatives, and accordingly, the types of risks that the AMF are concerned with do not apply to financial institutions. In addition, in CMIC's view, imposing the Certification Requirement could result in such corporate hedgers deciding not to undertake hedging

[4] As mentioned in Décision 2009-PDG-0009 -- January 22, 2009 - Bulletin de l'Autorité : 2009-01-23, Vol. 6 n° 3 : " An accredited counterparty that engages in a derivatives transaction is responsible for determining whether the other party is also accredited and whether the transaction thus benefits from the exemption set out in section 7 of the Act. To do so, the counterparty may rely on the factual statements made by the other party, <u>provided that it does not have reasonable grounds to believe that such statements are false.</u> <u>However, the counterparty is nonetheless responsible for determining whether, on the basis of the facts, the exemption is applicable</u>." [emphasis added]

transactions due to this additional operational complexity. Suppressing such counterparties from hedging risks is not consistent with managing risks within a well-functioning financial system.

If the Financial Institution Exemption recommendation is not adopted, CMIC reserves its right to submit further comments. As noted above, operationalizing the Certification Requirement is no small task to add to the already robust due diligence process currently being undertaken by financial institutions. Therefore, CMIC would like to propose specific operational comments if the Financial Institution Exemption is not adopted.

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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:

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