June 24, 2013

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

VIA ELECTRONIC MAIL

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Re: CSA Consultation Paper 91-407- Derivatives-Registration

Dear Members of the Canadian Securities Administrators:

I. INTRODUCTION.

Direct Energy Marketing Limited ("**Direct**") hereby submits comments to the Canadian Securities Administrators ("**CSA**" or the "**Administrators**") with respect to CSA Consultation Paper 91-407 – *Derivatives: Registration*, published on April 18, 2013 (the "**Consultation Paper**").[1] Direct appreciates this opportunity to submit comments, and looks forward to maintaining a dialogue with the CSA as it works to develop a workable and appropriately-tailored regulatory framework for the regulation of the derivatives marketplace in Canada.

Direct is one of North America's largest energy and energy-related service providers with over 6 million residential and commercial customer relationships. A subsidiary of Centrica plc (LSE: CNA), one of the world's leading integrated energy companies, Direct operates in 10 provinces in Canada and 46 states in the United States, plus the District of Columbia. In addition

[1] *See* Canadian Securities Administrators, CSA Consultation Paper 91-407 – Derivatives: Registration (April 18, 2013).

to owning and operating over 4,600 wells in Alberta with total natural gas production of 172 MMcfe per day, Direct's Midstream and Trading group performs a variety of physical and financial energy management activities, including production marketing and hedging, wholesale energy supply, transportation, and storage in Canada, much of which is necessary to support Direct's extensive consumer facing business. As a consequence, Direct has a clear interest in this proceeding.

II. COMMENTS OF DIRECT ENERGY MARKETING LIMITED.

A. General Comments.

1. The CSA's Focus Should Be on Identifying the Criteria that Would Require Registration

The CSA and the Consultation Paper should focus solely on identifying the criteria that would require an entity to register as Derivatives Dealer or Derivatives Advisor. The threshold questions of what activity would cause an entity to register and what entities should register are important and should be answered prior to designing the regulatory structure that would apply to those entities. To do otherwise may lead to a regulatory framework that is not appropriate for the markets and entities to which it is applied.

The registration triggers and requirements proposed in the Consultation Paper largely mirror those set forth in the securities context by National Instrument 31-103[2] ("NI 31-103"). While parts of that framework may be appropriate for derivatives markets, that framework should not be adopted using a "one-size-fits-all" approach. For example, many of the requirements imposed on Derivatives Dealers are appropriate in retail securities markets, but generally have no place in derivatives markets where trading relationships are traditionally principal-to-principal.

Direct urges the CSA to promulgate a definition of "Derivatives Dealer" that applies to firms commonly viewed as dealers in Canadian derivatives markets. As discussed further below, to do otherwise could cause risk and market share in energy derivatives markets to concentrate in large financial institutions and could increase cost for energy firms, which may ultimately raise energy cost for Canadian consumers.

With this in mind, the CSA should focus its initial efforts on (i) developing an appropriately-tailored definition of "Derivatives Dealer," (ii) developing a set of well-defined and workable factors (including any related interpretive guidance) that can be used to help market participants to determine whether they must register as a Derivatives Dealer ("Registration Factors"), and (iii) ensuring that it has the data necessary to understand (a) the types of entities that transact derivatives, (b) the nature and purpose of the derivatives transactions carried out by each type of entity, and (c) the systemic risk that exists in Canada's derivatives markets.[3]

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[2] Canadian Securities Administrators, National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (July 17, 2009).

[3] Direct respectfully suggests that the CSA consider adopting a phased process for implementing the registration requirements set forth in the Consultation Paper. In this respect, the CSA should work with provincial securities regulators to implement derivatives reporting regulations and gather data from trade repositories over a

2. Derivatives Reform Should Not Adversely Impact Canadian Energy Markets

The ongoing derivatives reforms effective in Canada will result in significant changes to Canadian derivatives markets. This transformation must be undertaken in a manner that avoids unintended consequences that could adversely impact domestic energy markets, including, but not limited to: (i) a loss of liquidity and corresponding increase in volatility resulting from regulations that are not appropriately tailored for derivatives markets; and (ii) uncertainty regarding the ultimate regulatory status of market participants.

Energy markets possess unique characteristics in terms of instruments, the market participants themselves, and the underlying physical products. Distinct from banks and financial institutions, which play an intermediary role in financial markets, energy firms typically do not play intermediary roles in such markets, and their derivatives trading activity is generally related to their respective physical businesses. In this respect, energy firms are "non-financial" in nature and, absent a significant engagement in identified derivatives dealing activity, should not be subject to comprehensive regulation as a "Derivatives Dealer."

Unlike financial institutions, energy firms primarily trade as principles by transacting energy-related derivatives to, among other things, hedge the risk associated with their core business of providing electricity, crude oil, natural gas, propane, gasoline, and other energy commodities to customers. The CSA should recognize that certain energy firms, while primarily engaged in hedging activities may also trade derivatives on a speculative basis or may be engaged in limited and discrete dealing transactions. However, these trading activities are ancillary and incidental to their primary physical business. In short, active participation in derivatives markets should not constitute derivatives dealing.

Equally, the CSA should recognize that, in energy markets, derivatives transactions are routinely executed *without* the involvement of dealers. This is because producers and users of a commodity generally have opposite risk profiles and can make natural hedging counterparties. In these transactions, neither counterparty is engaged in dealing activity, as such transactions are not entered into (i) as a service to, or for the benefit of, their counterparty, (ii) to collect a fee, or (iii) as a service to, or for the benefit of, the market generally, *i.e.*, to create or enhance liquidity.

Direct is concerned that the adoption of an overly broad definition of "Derivatives Dealer" will needlessly disrupt energy markets in Canada, as well as impair the operations of energy firms in Canada whose primary business involves the production, refining, marketing, transportation, and selling of physical commodities. Adopting a definition of "Derivatives Dealer" that captures energy firms that are active derivatives market participants will likely lead such firms to either (i) register as Derivatives Dealers, or (ii) reduce their use of financial derivatives markets to avoid registration as Derivatives Dealers. Both outcomes will increase

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minimum of a 12 month period. Such data will help provide the CSA with a thorough understanding of Canadian derivatives markets and facilitate the adoption of an appropriately-tailored framework for the regulation of Derivatives Dealers. *See* Canadian Securities Administrators, Multilateral CSA Staff Notice 91-302 – Updated Model Rules: Derivatives Product Determination and Trade Repositories and Derivatives Data Reporting (June 6, 2013).

costs for those market participants. Registering as a Derivatives Dealer will increase compliance costs. Reducing trading activity likely will reduce such firms' ability to hedge or hedge efficiently, increasing risks and, consequently, costs.

For example, if a broad definition of "Derivatives Dealer" requires Direct to register as such, mandatory margin and capital requirements would divert valuable working capital from Direct's physical business, reducing its ability to invest in new projects. In the alternative, if a broad definition of "Derivatives Dealer" causes Direct to limit its participation in derivatives markets, it will become increasingly reliant on large financial institutions for its hedging needs. If a number of energy firms make a similar choice to avoid registration as a Derivatives Dealer, risk will become increasingly concentrated in a small number of market participants and the number of possible counterparties for non-Derivatives Dealers likely will decrease significantly. In addition to concentrating risk in the financial sector, these scenarios will result in higher prices for energy and energy-related products consumed by Canadian citizens. These outcomes would seem to be in direct conflict with the CSA's goals of reducing risk and protecting Canadian market participants.

B. Definition of "Derivatives Dealer."

1. The Proposed Definition of "Derivatives Dealer" Should Be Narrowly and Precisely Defined

The express language proposed by the CSA stating that "persons carrying on the business of **trading** in derivatives"[4] (emphasis added) should be deemed Derivatives Dealers is overly-broad and, without further definitional clarity, could be interpreted to capture all active participants in derivatives markets. As an initial matter, the definition of "Derivatives Dealer" should focus exclusively on those types of activities that are routinely regarded within derivatives markets as *de facto* "dealing activity."

Although Direct understands that similar language is used in the context of determining whether an entity is a securities dealer,[5] the concept of a "Derivatives Dealer" implicates different markets and different products and should be defined in an appropriate and precise manner. The phrase "trading in derivatives" confuses the scope and applicability of this definition by arguably capturing non-dealing trading activities, particularly speculative trading activity, which, as discussed below, is a separate and distinct form of market behavior from dealing activity.

Market participants trading for their own account and profit are commonly thought to be engaged in "trading activity," while market participants entering into derivatives transactions for express purposes of making markets, providing liquidity, or functioning as an intermediary on behalf of a customer are engaged in "dealing activity." With this in mind, the CSA should consider modifying the proposed definition of "Derivatives Dealer" to refer to "persons carrying on the business of **dealing** in derivatives" (emphasis added).

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4 *Consultation Paper* at 4,125.

5 *Companion Policy to NI 31-103* (July 17, 2009) at 269.

The Derivatives Dealer registration determination must ultimately focus on whether, and to what extent, an entity engages in *dealing* activity. As discussed further in Sections II.B.3. and II.B.4. below, the definition of "Derivatives Dealer" should contain explicit language carving out any non-dealing trading activity engaged in by a market participant for its own account. In addition, a *de minimis* threshold up to which an entity may engage in dealing activity without having to register as a Derivatives Dealer should be expressly incorporated in the definition.

2. The CSA Should Provide More Guidance Regarding the Factors For Determining Whether a Person is "In the Business of Trading Derivatives"

The definition of "Derivatives Dealer" is qualitative in nature in that it is based on the functional role a participant plays in the market. As such, this definition should only cover a limited set of market participants engaged in specific types of activity. Direct is concerned that the proposed definition of "Derivatives Dealer," when read in conjunction with certain of the factors listed in Section 6.1(b) of the Consultation Paper will capture a set of derivatives market participants much larger than those entities engaged in the business of dealing derivatives as their primary business.

That said, Section 6.1(b) contains certain "Registration Factors" that appear to correctly identify general types of behavior that are generally characterized as "dealing activity." These factors broadly align with Direct's understanding of what constitutes dealing activity in derivatives markets. In particular, the key Registration Factors include those focused on derivatives market participants that

- act as an intermediary, rather than trading for its own hedging, investment, or other permissible objective;
- act as market maker; or
- provide clearing services.

When engaging in each of the activities listed above, Derivatives Dealers typically remain neutral to price movements in the relevant derivatives instrument, as they are compensated through fees and through the difference in the bid/ask spread.

While the activities identified above are appropriate for determining whether and entity is acting as a Derivatives Dealer, to ensure that the scope of the definition of "Derivatives Dealer" is appropriately tailored, further clarification of what specifically constitutes the enumerated types of dealing activity is required. Direct highlights three distinct areas where such clarification is required.

a. Market-Making.

The use of the term "market-making" without further definition and clarification is susceptible to overly broad and potentially conflicting interpretations. A hallmark of market making activity is that a market participant is continually ready, willing, and able to take either side of a derivatives transaction. In general, market makers seek to remain neutral to price movements with respect to the derivative at issue, as well as the underlying commodity. They

profit, in large part, from the bid/ask spread, intermediation fees, or ancillary services related to their dealing activity (*e.g.*, providing investment advice), not from realizing changes in the value of the derivatives transacted or the underlying commodities.

Although a commercial energy firm may, on occasion, take either side (*i.e.*, short or long) of a particular derivatives transaction, this behavior may be distinguished from market-making activity as it is driven by the commercial energy firm's primary physical business.[6] Such activity is generally carried out for the purpose of (i) a function of changes in the risk associated with underlying physical positions, or (ii) discovering a price for a derivatives transaction or, in the case of physical commodities, the underlying commodity.

To avoid the overly broad application of the term "market maker," Direct recommends that the CSA develop interpretive guidance, such as enumerated criteria, that clarifies the meaning and scope of this language. For example, an entity would be engaged in market making in derivatives markets if it provided two-sided pricing (i) for a customer and such pricing does not take a distinct view on the market (*i.e.*, the pricing largely reflects the current bid/ask spread), or (ii) pursuant to a contractual obligation (*i.e.*, an obligation to buy when there is excess of sell order s and to sell when there is an excess of buy orders.)

Further, the CSA should note that offering two-sided pricing should not be treated as sole indicia of whether an entity is engaged in market making. Rather, offering an occasional two-way price quote, when done for customary commercial purposes, such as price discovery, does not fall within the type of "continuous ready, willing, and able" trading activity that is key indicium of a dealer engaged in market making in derivatives markets.

b. Trading Compensation.

The CSA should clarify that "trading with the intention of being remunerated or compensated" refers explicitly to (i) fees for acting, or providing services, on behalf of customers, (ii) money made in a market making function, or (iii) a payment for fulfillment of a contractual obligation to act as a market maker. The language as written, even when read in conjunction with the Companion Policy to NI 31-103,[7] opens up the possibility that trading profits generated by beneficial markets could be indicia of dealing activity.

c. Solicitation of Interest.

The CSA should make clear that "directly or indirectly soliciting" includes scenarios in which an entity does ***not*** have a view of the market and seeks out a counterparty to facilitate the goals of that counterparty. This language should cover legal entities or functional business units

[6] As discussed further in Section 3(d), below, in certain derivatives markets, particularly those tied to physical locations, only a few firms trade. This applies in Canada with respect to certain energy-related derivatives (notably swaps). Any interpretive guidance developed or proposed by the CSA should recognize that providing or eliciting two-way pricing in non-liquid or episodically liquid markets does not, by itself, constitute dealing activity, as such activity is necessary to efficiently hedge the risks unique to that specific location.

[7] Direct Energy has been instructed by various regulators to consider the Companion Policy to NI 31-103 as pertinent guidance for the Consultation Paper.

of a legal entity whose primary strategic objective is to solicit new business from customers pursuant to which it will act as an intermediary by providing access to derivatives markets, or as a maker of derivatives markets, for the benefit of their customers. It should not cover scenarios in which one market participant asks another market participant to enter into a derivatives transaction on a principle-to-principle basis, and where each counterparty is (i) acting for its own account and economic benefit (not the benefit of its counterparty), and (ii) not agnostic to changes in price of the derivative at issue or the underlying physical commodity.

3. The Definition of "Derivatives Dealer" Should Expressly Exclude "Non-Dealing Activity"

The definition of "Derivatives Dealer" should be drafted in a manner that recognizes that a large portion of commodity derivative market participants engage in (i) trading activity that is not derivatives dealing activity, and/or (ii) limited derivatives dealing. These trading activities are incidental or ancillary to their underlying primary, physical business operations. With this in mind and to provide regulatory certainty that such market participants are not Derivatives Dealers, the CSA should explicitly recognize that:

- Hedging is not dealing activity;
- Speculation is not dealing activity;
- Anonymous on-facility transactions generally are not dealing activity;
- Providing two-sided pricing in markets with limited or episodic liquidity is not dealing activity; and
- Frequent trading activity in derivatives markets is not dealing activity.

Direct urges the CSA to create an explicit exemption from registration as a Derivatives Dealer for market participants that predominantly engage in any non-dealing activity, including (but not limited to) the activities outlined above. Such an exemption would be consistent with the approach to regulation under the Companion Policy to NI 31-103, which directs regulators to look to the business purpose of an activity to determine whether that activity should require registration.[8] The rationale for including these activities in a general exemption from the definition of "Derivatives Dealer" is set forth below.

a. Hedging.

Many commodity market participants (including energy firms) enter into derivatives to hedge the commercial risk that arises from their physical operations. Hedging is a legitimate risk management activity. When hedging, an entity acts for its own account and not as an intermediary for the benefit of third parties. Hedging, in and of itself, does not pose a risk to the market. In the context of commodity markets, the general objective of hedging is to reduce the risk inherent in a business that is dependent on production, processing, merchandizing, or consumption of physical commodities. For example, an airline may choose to fix the price of its

[8] *Companion Policy to NI 31-103* at 268.

fuel purchases so it has price certainty and can focus on the business of running an airline. Or, an electricity generator that sells to customers at unfixed prices may choose to hedge a fixed price contract for natural gas (*i.e*, convert the natural gas contract into a floating rate contract using a swap) so its floating rate revenue is matched to correlated floating rate costs. In each example, the hedging activity is net risk reducing. Net risk reducing trading activity is the type of market behavior that is appropriately excluded from the definition of "Derivatives Dealer."

b. Speculative Trading.

Speculation is also a legitimate, non-dealing market activity. Distinct from entities engaged in dealing activity, market participants engaged in speculative trading are not neutral to price movements in derivatives markets and underlying commodity markets. An entity engaged in speculative trading acts for its own account, not as an intermediary for the benefit of unaffiliated third-parties. Such trading activity is entered into specifically for purposes of benefiting from changes in the price of the instrument.

Additionally, speculative trading can perform a price discovery function. In this respect, speculative trading (i) provides price information that allows a market participant to hedge more effectively, and (ii) prevents counterparties from anticipating the trading needs of entities that also use commodity derivatives to hedge. If the CSA is concerned that speculative trading may introduce systemic risk into the derivatives markets, then this issue should be addressed as part of the Large Derivatives Participant ("LDP").

c. Trading "On-Facility."

Additionally, transacting derivatives "on-facility" (*i.e.,* on an electronic trading facility or centralized market) generally is not viewed as dealing activity unless a market participant is contractually obligated to perform a dealer-type function, such as that of a market maker. In order to provide regulatory certainty and clarity, the CSA should explicitly state in the final version of its model rules on registration that derivatives transactions in which counterparties are anonymously matched are not "dealing" activity.

d. Providing Two-Sided Pricing in Markets with Limited or Episodic Liquidity.

The CSA should make explicitly clear that providing two-sided pricing in markets with limited or episodic liquidity either for the purpose of (i) discovering a price for a derivative or underlying commodity, or (ii) eliciting bids and offers from other market participants does not constitute derivatives dealing activity. Such activity is not dealing because the fundamental purpose is price discovery. This activity should not be considered "market making" given that the market participant providing the two-sided pricing is doing so to facilitate its own derivatives trading to further its commercial business and is not continuously standing ready, willing, and able to engage in such conduct.

e. Frequent Trading Activity in Derivatives Markets.

Finally, in response to Question 6 in the Consultation Paper, Direct strongly encourages the CSA to include "***frequent derivatives dealing activity***" and not "frequent derivatives trading activity" as a factor to consider in determining whether an entity triggers the registration requirement. More importantly, Direct urges the CSA to provide clarity as to the "frequency" of dealing activity that would give rise to the Derivatives Dealer registration requirement. Without such guidance, market participants will grapple with the concept of being "in the business" of

dealing derivatives. At a minimum, the CSA should clarify that nominal or irregular dealing activity or dealing activity that is ancillary to an entity's primary physical business, has a business purpose of supporting such primary business and will not lead to the entity's categorization as a Derivatives Dealer.

4. Registration as a Derivatives Dealer Should Be Subject to a *De Minimis* Exception

In keeping with the importance of developing an appropriately scoped definition of "Derivatives Dealer," the CSA should create an exception from the definition for market participants that engage in a *de minimis* amount of derivatives dealing activity. A *de minimis* exception is necessary for two major reasons:

First, imposing a registration requirement on market participants that enter into a small amount of derivatives dealing activity that is incidental and ancillary to their core business will likely result in their discontinuing such activity. Forcing these entities out of the market will have the consequence of concentrating risk within large financial institutions and reducing market liquidity. This will limit choice and increase volatility – both of which could increase the cost of hedging, potentially increasing the costs of energy consumers.

Second, without a *de minimis* exception, a single dealing transaction or several small dealing transactions could trigger a registration obligation. A *de minimis* exception would limit that possibility and provide market participants with certainty as to their non-dealer status.

To the extent that the CSA adopts the precedent, facts and circumstances approach similar to the approach set forth in NI 31-103,[9] then a *de minimis* exception may only be necessary temporarily as an adequate precedent for what kind of activity constitutes "carrying on the business of dealing in derivatives" is developed as entities that are clearly derivatives dealers register as such.

Further, any *de minimis* threshold level proposed by the CSA should not be set at an unduly restrictive level. For example, natural gas prices are depressed compared to prior periods of strong and sustained economic growth. If a proposed *de minimis* threshold is set at an unduly restrictive level, market participants transacting natural gas derivatives that currently fall below such a threshold could easily violate it in the future simply due to rising energy prices.

Finally, adopting a *de minimis* exception would, at a high-level, structurally align the Canadian derivatives regulatory paradigm with the regulatory infrastructure in the United States. In general, Direct believes that where alignment between the two regulatory regimes is possible, the CSA should make the effort to do so. A large percentage of derivatives market participants in Canada trade in the United States as well, and aligning the regulatory requirements in the two countries will minimize opportunities for regulatory arbitrage and will reduce compliance burdens on market participants.

[9] One of the primary factors relied upon in determining if an entity has engaged in "securities trading for a business purpose" is whether that entity is engaged in activities similar to those of a registered securities dealer. *Companion Policy to NI 31-103* at 268. The Consultation Paper includes a similar factor in the Derivatives Dealer context. *Consultation Paper* at 4,127.

C. The Consultation Paper Should Address How the Proposed End-User Exemption Would Operate in Conjunction with the Derivatives Dealer Registration Regime.

In order to ensure market certainty, Direct also urges the CSA to provide more guidance on how this Consultation Paper operates in conjunction with *Consultation Paper 91-405 – Derivatives: End-User Exemption*, published on April 13, 2012,[10] and how entities falling outside the registration regime and End-User Exemption would be regulated under this framework. Direct intends to provide separate comments on the breadth (or lack thereof) of the CSA's End-User Exemption, but generally believes that the Consultation Paper should clearly and succinctly operate in tandem with the End-User Exemption, such that all Canadian derivatives market participants have the ability to understand their regulatory classification with respect to their derivatives activities.

Currently, entities that are "in the business of trading derivatives" will be required to register as Derivatives Dealers, while entities that, generally speaking, solely transact in derivatives for hedging purposes will be eligible for the End-User Exemption. This overlapping, dual approach creates uncertainty for entire classes of market participants (*i.e.* those that engage in some dealing or speculative activity) as to how they would be regulated under the CSA's proposed reforms. The CSA should assure that *all* market participants understand the implications of these regulatory reforms and have an opportunity to comment on proposed regulations that stand to impact their businesses.

Further, Direct encourages the CSA to allow for all non-registered entities (*e.g.*, those entities that are not Derivatives Dealers, Derivatives Advisers, LDPs, etc.) to qualify for the End-User Exemption. Direct believes that market participants that (i) predominantly engage in non-dealing activity and (ii) are not required to register with the CSA in any derivatives-related capacity should be able to use the End-User Exemption.

D. The CSA Should Provide Clarity with Respect to Certain Jurisdictional Issues Under the Consultation Paper.

Under the Consultation Paper, entities that meet the definition of "Derivatives Dealer" would be required to register as such in *each* Canadian province and territory where they conduct derivatives trading business, unless an exemption is available. However, the goal of the CSA in undertaking this process is to ensure a uniform set of rules and obligations. Applying conflicting or duplicative requirements on entities transacting in multiple provinces would be contrary to that goal. As such, Direct encourages the CSA to provide that an entity registered as a Derivatives Dealer should be subject to the regulatory obligations imposed upon it by its principal jurisdiction and should only be required to make a notice filing with a foreign jurisdiction's regulator when transacting outside of their principal jurisdiction.

Foreign entities that are registered as the equivalent of a "Derivatives Dealer" or LDP in a foreign jurisdiction, and that are subject to a regulatory regime equivalent to that of a Canadian jurisdiction in which they operate, would be exempt from certain regulatory requirements under the CSA framework. Such foreign dealers would in all cases be required to:

[10] *See* Canadian Securities Administrators, CSA Consultation Paper 91-405 – Derivatives: End-User Exemption (April 13, 2012).

(i) Register in the Canadian jurisdiction where their counterparty resides;
(ii) Comply with certain business conduct standards;
(iii) Comply with certain disclosure and reporting requirements; and
(iv) Provide the "relevant Canadian authorities" with adequate information to enable them to determine that the foreign dealer is subject to substantially equivalent regulations.

These requirements would apply even where both parties have operations in a foreign jurisdiction and the transaction is booked outside Canada.

Direct believes that this regulatory regime for foreign dealers is overly burdensome. As a starting point, Direct strongly encourages the CSA to create no more than one registration requirement (and one set of ensuing regulatory obligations) for foreign dealers that transact with counterparties in more than one Canadian province. Foreign dealers, like domestic dealers, should be subject to only a notice in provinces other than their principal jurisdiction in which they transact.

The CSA also should clarify that foreign dealers entering into derivatives transactions with non-Canadian affiliates of Canadian entities that are booked outside Canada will not be subject to regulation by any Canadian regulatory authority.

Finally, in its regulatory reform efforts, Direct respectfully requests that the CSA address jurisdictional issues for *all* foreign entities transacting with Canadian counterparties, and not just foreign *dealers* transacting with Canadian counterparties or clients. Direct cautions the CSA that any jurisdictional overreach in derivatives regulation has the potential to create a barrier to entry for non-Canadian entities to transact in Canada. Any such deterrent to doing business in Canada may lead to fewer market participants, which in turn may lead to less liquidity and higher prices for the remaining Canadian market participants. As such, Direct urges the CSA to carefully and narrowly structure a cross-border regime as part of Canada's derivatives reform efforts.

E. LDP Registration Requirements Should Be Addressed in its Own Consultation Paper.

Direct would like to offer comment on the LDP paradigm proposed in the Consultation Paper. However, this paradigm as set forth therein is incomplete. The Consultation Paper defines a "Large Derivatives Participant" as "a Canadian resident entity that maintains a substantial position in a derivative or a category of derivatives." Other than looking to the Major Swap Participant standard in the United States, which uses similar language,[11] it is difficult to determine the scope of the LDP standard.

Although the CSA states that it will undertake the determination of registration thresholds for LDPs in a separate effort,[12] prior to doing so, the CSA should make clear the underlying purpose of the LDP regulatory paradigm. Direct believes that LDP registration should be required of entities that have large uncollateralized derivatives exposures. It should not be

[11] Commodity Futures Trading Commission Final Rule on *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant*." 77 Fed. Reg. 30596 (May 23, 2012).

[12] *Consultation Paper* at 4,129.

required of entities that predominantly use derivatives to hedge. Hedging is a risk reducing activity. It creates so-called "right way risk." That is to say that when an entity hedges any losses on its derivatives, positions are typically offset by gains on the underlying position being hedged. As such, Direct requests that hedge positions be excluded from the LDP analysis. At the very least, the lower-risk nature of hedge positions should be accounted as the LDP paradigm is created.

III. CONCLUSION.

Direct supports the adoption of an appropriately-tailored regulatory framework for Canadian derivatives markets and respectfully requests that the Administrators consider the comments set forth herein.

If Direct can offer any assistance to the Administrators as regulatory reform efforts move forward, please contact me at 403-776-2246.

Sincerely,

/s/ Bill Rutherford

Bill Rutherford
Credit Risk Officer
Direct Energy Marketing Limited