



June 17, 2013

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New Brunswick Securities Commission  
Nova Scotia Securities Commission  
Ontario Securities Commission OTC Derivatives Committee

Dear Sirs/Mesdames:

**RE: Encana Corporation – Comments on CSA Consultation Paper 91-407 – Derivatives:  
Registration**

Encana Corporation (“Encana”) is pleased to respond to your request for comments with respect to the above captioned.

### **General Comments**

We believe that the following principles should be reflected in the regulatory framework:

#### **1) One transacting entity, one jurisdiction**

- Encana agrees that it is sometimes appropriate to require entities to register as active in multiple jurisdictions, based on their counterparties, but we believe that the approach for the majority of transacting entities should be to require them to register in one jurisdiction only.
- We appreciate the Committee’s efforts to ensure entities are not subject to the requirements associated with derivatives regulations of multiple “deemed equivalent” jurisdictions in such situations.
- Encana believes that additional clarity is required regarding the appropriate actions of a party to a financial derivative transaction when its counterparty is not subject to “deemed equivalent” derivatives regulations.

**Encana Corporation**

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## 2) Transactions do not have jurisdictions, only transacting entities do

- We respectfully suggest that it is not practical to define the jurisdiction of financial transactions. While the physical location of an exchange may define the jurisdiction of exchange-traded instruments, many OTC transactions are not readily associated with a unique jurisdiction.
- Regulatory rules will function more effectively if they focus on the jurisdiction of the transacting entities rather than on the jurisdiction of the financial transaction.

## 3) Derivatives regulations of exchange-traded and over-the-counter (OTC) instruments

- The Committee stated the purpose of registration is to fulfill part of Canada's commitment to the G20 to reform OTC derivatives markets. However, the registration requirements described in 91-407 do not appear to distinguish between exchange-traded and OTC instruments. We suggest clarity be given as to whether derivatives registration requirements are to encompass activity in both exchange-traded and OTC instruments or only OTC instruments.

### Specific Comments and Responses to Questions

#### Part 6 REGISTRATION REQUIREMENT AND CATEGORIES OF REGISTRATION

*“The Committee understands that participants in the derivatives market include a variety of entities ranging from very large and sophisticated entities to individuals and small entities that may have little experience in trading derivatives. The Committee believes that participants that do not have the experience necessary to understand the obligations and risks related to a derivatives transaction or the resources necessary to easily meet their obligations may benefit from additional protection that is not appropriate for large, sophisticated participants.” ((2013) 36 OSCB 4124, emphasis added)*

*“Q2: What is the appropriate standard for determining whether a person is a qualified party? Should the standard be based on the financial resources or the proficiency of the client or counterparty? If the standard is based on financial resources should it be based on the net assets of the client or counterparty, gross annual revenues of the client or counterparty, or some other factor or factors?”*

ENCANA COMMENT: We do not believe that unsophisticated parties are best protected through the imposition of additional protections for those parties in the regulations; rather, we suggest that the best way to protect unsophisticated parties is by limiting or excluding their participation in the derivatives market. We suggest that categorization of parties both by status as “qualified” vs. “unqualified” and by type of market participant (Derivatives Dealer, Derivatives Advisor, etc.) is redundant. The Committee should adopt a single set of defined categories of market participants and exclude parties in categories deemed insufficiently sophisticated to participate in the derivatives market. Concepts and definitions set out in documents promulgated by provincial securities commissions, such as the Alberta Securities Commission Blanket Order 91-505, may be helpful in developing and articulating appropriate categories.

## 6.1 Derivatives Dealer

*“The Committee believes that persons carrying on the business of trading in derivatives or holding themselves out to be carrying on that business, should be regulated.” ((2013) 36 OSCB 4125)*

ENCANA COMMENT: As mentioned above, the Committee does not appear to distinguish between exchange-traded and OTC derivatives. We feel this distinction is important as we believe the intention of these regulations is to focus on the OTC markets.

Within the OTC markets, we suggest regulations distinguish “Derivatives Traders” from “Derivatives Dealers.” We recommend defining “Derivatives Traders” as entities in the business of generating profits from speculating in OTC derivatives markets. We recommend defining “Derivatives Dealers” as “Derivatives Traders” that also engage in such activities as:

- i. Acting as a market maker;
- ii. Intermediating trades; or
- iii. Providing clearing services to third parties.

We believe the distinction between “Derivatives Traders” and “Derivatives Dealers” is important because each group raises different concerns for regulators. We further suggest the Committee only focus on participants with positions or activity beyond an appropriate de minimus threshold. Calculation of this de minimus threshold should exclude OTC transactions that can legitimately be claimed to be “hedged” in that they offset underlying commercial risk. We also suggest that the Committee should reconsider some of its recommended triggers for classifying OTC derivative market participants. Specifically ((2013) OSCB 4126, 4127):

*“(iii) Trading with the intention of being remunerated or compensated”*

ENCANA COMMENT: This trigger is ambiguous because it seems to cover every possible rationale for entering into a derivative transaction. For example, a common objective of a company executing a derivative transaction to offset its underlying risk in a physical market is to reduce the volatility of its cash flows. How would the Committee consider the person executing this derivative transaction if the person is rewarded for how effectively cash flow volatility is mitigated? The trigger, as currently articulated, does not seem to be helpful in identifying conduct that should be subject to regulation.

*“(iv) Directly or indirectly soliciting”*

ENCANA COMMENT: This trigger appears to encompass any activity undertaken with the intention of entering into a derivative transaction, regardless of the type of entity, the business purpose behind the derivative or the sophistication of the entity. This trigger, as currently articulated, is overly broad.

*“(vi) Trading with a counterparty that is a non-qualified party that is not represented by a derivatives dealer or adviser on a repetitive basis”*

ENCANA COMMENT: As mentioned above, Encana suggests that designating parties as “qualified” or “unqualified” is redundant with a more accurate categorization of market participants based on size and sophistication.

Moreover, as long as a party is permitted to participate in the OTC derivatives market, this proposed trigger is problematic because it does not address the situation where two non-qualified counterparties (or two counterparties in the same derivatives market category) enter into derivative transactions. We recommend that some form of master agreement be established before two entities are allowed to execute OTC derivative transactions. We suggest that the category or status of each party should be ratified between each pair of transacting entities through this master agreement governing their derivative transactions. Within this ratification and where agreeable to both parties, contracting parties should have the freedom to waive their category-appropriate rights.

### **6.3 Large Derivative Participant**

ENCANA COMMENT: The reference to “...*the entity’s exposure in Canadian derivatives markets...*” ((2013) 36 OSCB 4129, emphasis added) assumes it is possible to define a nationality for derivative markets. We do not believe this is possible for OTC derivative markets. Accordingly, we suggest that the Committee should instead focus on defining the derivatives jurisdiction of derivative markets participants.

*“Q9: Are the factors listed for determining whether an entity is a LDP appropriate?”*

ENCANA COMMENT: We agree that the definition of an LDP should include (1) Canadian resident entities, and (2) foreign resident entities with positions with Canadian resident entities. However, LDP designation should not be based the “residency” of the derivatives market because the residency of a market can be impossible to define. Additionally, the LDP designation should be based on an “appropriate level” of net exposure to derivatives markets (i.e., offsetting long positions against short positions). The “appropriate level” should be set by each regulator. Derivative transactions intended to mitigate an underlying physical or commercial exposure should be excluded from the calculation of this net position.

*“Q13: Is the Committee’s proposal to impose a requirements on registrants to “act honestly and in good faith” appropriate?”*

ENCANA COMMENT: The requirement to act honestly and in good faith should be a requirement of all market participants, regardless of their category or classification. This requirement goes to the very integrity of the market.

*“Q14: Are the requirements described appropriate registration requirements for derivatives dealers, derivatives advisers and LDPs? Are there any additional regulatory requirements that should apply to all categories of registrants? Please explain your answers.”*

ENCANA COMMENT: Given the unique nature of OTC derivatives markets, we recommend a proficiency requirement for derivative market participants that falls outside the definitions of Derivatives Dealers, Derivatives Traders, Derivative Advisers and LDPs. The traders and/or supervisors at all derivative market participants should be able to demonstrate a certain level of proficiency. Only Derivative Dealers, Derivative Advisers and LDPs should be subject to financial and solvency requirements.

*“Q15: Should derivatives dealers dealing with qualified parties be subject to business conduct standards such as the ones described in part 7.2(b)(iii) above? If so, please explain what standards should apply.”*

ENCANA COMMENT: We support business conduct standards, but are concerned with how they will be implemented in practice. Typical OTC derivative transactions are executed in a matter of seconds between the traders of two counterparties. This is typically the case even for transactions involving non-qualified entities. Providing pre-trade reports or obtaining independent advice before entering into each individual transaction is problematic when multiple transactions can be executed in a matter of minutes. Conversely, prohibiting transactions between a non-qualified counterparty and a derivatives dealer with a conflict of interest is likely too restrictive. We suggest an alternative where several levels of business conduct standards are formulated and each pair of counterparties are able to adopt the level of business conduct standards most conducive to their level of transacting activity. We suggest that the Committee should define a series of alternative business conduct standards, any one of which could be incorporated into an ISDA amendment between two counterparties.

*“Q16: Do you have a preference between the two proposals relating to the regulation of a derivatives dealer trading with counterparties that are non-qualified parties? Is there another option to address the conflict of interest that the Committee should consider? Please explain your answer.”*

ENCANA COMMENT: Please refer to the above comment to Q15.

*“Q22: Is the proposal to exempt crown corporations whose obligations are fully guaranteed by the applicable government from registration as a LDP and, in the circumstances described, as a derivatives dealer appropriate?”*

ENCANA COMMENT: Encana respectfully submits that governments and crown corporations should not be exempt from registration. Governments and crown corporations engender the same concerns regarding derivatives transactions as all other parties. Recent events in California, Greece, Cyprus and Ireland, among others, show the impacts governments can suffer as a result of participating in derivatives transactions. Additionally, branches of government can be privatized, which could create a question of whether a newly privatized entity would be required to register when it already has a significant portfolio of existing derivative transactions from its formerly exempt status.



Please contact me at (403) 645-7519 or by email at [scott.dalton@encana.com](mailto:scott.dalton@encana.com) if you have any questions.

Yours very truly,

**ENCANA CORPORATION**

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