INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

June 17, 2013

DELIVERED VIA EMAIL

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
Fax: (416) 593-2318
E-mail: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec
H4Z 1G3
Fax : (514) 864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

Re: CSA Consultation Paper 91-407 – Derivatives: Registration (the "Paper")

The Investment Industry Association of Canada ("IIAC") appreciates the opportunity to provide comment on CSA Consultation Paper 91-407 – Derivatives: Registration. Our comments reflect the views of the IIAC Derivatives Committee which is comprised of senior professionals with responsibilities for derivatives markets activities and compliance.

The IIAC is the professional association for the securities industry, representing close to 170 investment dealers regulated by the Investment Industry Regulatory Organization of Canada ("IIROC"). Our mandate is to promote efficient, fair and competitive capital markets for Canada and to assist our member firms across the country.

IIROC regulated investment dealers play a recognized role in the exchange-traded derivatives market, participating as registered dealers and market-makers. Some IIROC dealers engage exclusively in derivatives.

IIAC members also participate in the over-the-counter (OTC) derivatives market, primarily in foreign exchange (FX) and contracts for differences (CFDs). CFDs and FX contracts are distributed to the retail market in Canada through registered investment dealers that are subject to strict terms and conditions of their registration, including capital, segregation, supervisory, reporting and proficiency requirements. These transactions are well regulated, do not involve institutional counterparties and do not contribute to systemic risk.

Our comments should be received in the context of our recent representations to the Canadian Securities Administrators ("CSA") and IIROC that the pace and breadth of regulatory initiatives in Canada is overwhelming our members at of time of declining revenue in several sectors of activity. We estimate that 65 dealers have lost money on a consistent basis over the past 2 years and the increased cost of regulation is often one of the main factors affecting their profitability.

Some IIAC members or their affiliates, and other industry groups in which they participate, may address in separate letters to the CSA issues raised by the Paper, based on their role in the market and their regulatory situation. Our comments are meant to supplement those submissions.

General Comments

Our members recognize the importance of implementing a regulatory framework for OTC derivatives that, as stated by the CSA in Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada ("CP 91-401"), is …" intended to strengthen Canada's financial markets and manage specific risks related to OTC derivatives, implement G20 commitments in a manner appropriate for our markets, harmonize regulatory oversight to the extent possible with international jurisdictions, all while avoiding causing undue harm to our markets".

Notwithstanding our support for the CSA's efforts in this sphere, we strongly believe that a new registration regime is unnecessary and should therefore not be implemented in Canadian derivatives markets. We are of the view that the implementation of G20 commitments and the effective management of risks related to OTC derivatives can be achieved within the framework of registration regimes already in place; G20 commitments do not contemplate a specific registration regime for OTC derivatives. Other jurisdictions – notably the European Union – are currently implementing G20 commitments within their existing registration regime. We also submit that the implementation of a new registration regime for OTC derivatives in the US – the sole jurisdiction to do so – is mandated by the Dodd-Frank Act and motivated by issues that are specific to the US market.

We also believe the need for changes or additions to the existing registration regime can be best assessed once other initiatives contemplated in CP 91-401 have been implemented, including Trade Repositories ("TR") and Central Counterparty Clearing ("CCP Clearing"). Together with the use of unique identifiers, TR and CCP Clearing will provide Canadian regulators and the Bank of Canada with the necessary data and tools to monitor systemic risk exposures of market participants, detect possible market abuse and assist in the

performance of systemic risk analysis on these markets. TR and CCP Clearing will require substantial investment in technology and operations on the part of industry participants and we believe that is where efforts should be concentrated.

We strongly believe that a new registration regime is unnecessary and should therefore not be implemented in Canadian derivatives markets. We therefore recommend that Canadian regulators implement G20 commitments within the existing registration framework. The need for changes or additions to the existing registration regime can be best assessed once other initiatives contemplated in CP 91-401 have been implemented, including Trade Repositories and Central Counterparty Clearing. Furthermore, if and when regulators choose to proceed with the implementation of a new regulatory regime, IIROC regulated firms should be exempt.

Our second general comment pertains to the definition of "derivatives". Although the Paper is part of a series that build on the regulatory proposals contained in CP 91-401, it is unclear that the scope of the Paper is limited to OTC derivatives. We strongly believe that listed derivatives should be excluded from the scope of CP 91-407, because the regime contemplated in the Paper would impose significant and unnecessary regulatory obligations and costs on firms dealing in listed derivatives. These firms are already subject to a registration regime and regulatory obligations that have proven very effective at ensuring market integrity and investor protection and we fail to understand what would justify a reform of that regime at this point. In fact, given that many of our member firms are already struggling to cope with the drastic increase in the cost of regulation in a context of a prolonged decline in trading activity, the adoption of an additional registration regime may push some of these firms to exit the listed derivatives market. That would limit investors' choice and potentially reduce liquidity in the market.

We therefore ask the CSA Derivatives Committee (the "Committee") to confirm that listed derivatives are excluded from the scope of the Paper.

Unless otherwise noted, our comments on specific questions assume that listed derivatives are excluded from the scope of the Paper.

Specific comments

As stated in our general comments, we strongly believe that a new registration regime is unnecessary and should therefore not be implemented in Canadian derivatives markets. Nonetheless, we believe it is still useful to comment on the specific issues raised in the Paper in order to bring to the Committee's attention some of our concerns with the contemplated regime. Unless otherwise noted, our comments assume that listed derivatives are excluded from the regime.

<u>The CRO</u>

We submit that the requirement to appoint a Chief Risk Officer is not appropriate, particularly in the case of some of the smaller IIROC members that are not large OTC

derivatives participants and do not maintain significant proprietary positions. The need for this new role for IIROC members has not been demonstrated from the point of view of market integrity or systemic risk.

IIROC members already have strict OTC derivatives risk management obligations under Rule 2600, Policy Statement 8 – Derivative Risk Management ("Policy Statement 8"), which states:

> *"This policy statement includes all types of derivatives i.e. exchange traded and over-the-counter derivatives.*
>
> *The control objective is to ensure that:*
>
> > *a) There is a risk management process of identifying, measuring, managing and monitoring risks associated with the use of derivatives.*
> >
> > *b) Management demonstrates their understanding of the nature and risks of all derivative products being used in treasury, trading and sales.*
> >
> > *c) Written policies and procedures exist that clearly outline risk management guidance for derivatives activities."*

Furthermore, Policy Statement 8 imposes what we believe is the equivalent of a CRO position:

> *"Dealer Members must have a risk management function, with clear independence and authority to ensure the development of risk limit policies and monitoring of transactions and positions for adherence to these policies."*

The appointment of a CRO would add unnecessary and significant costs, without measurable benefits, in a context of declining trading volumes and margins and should therefore not be imposed upon IIROC members.

<u>Dealing with non-qualified parties and conflicts of interest</u>

When dealing with non-qualified parties, we recommend that written disclosure be provided during the account opening/documentation process and that the non-qualified party be allowed to provide a blanket acknowledgement indicating that they were electing not obtain independent advice. A similar disclosure could also be included on post trade reports. More detail is provided in our answer to question 16 below.

Answers to Committee questions

We have reviewed the specific questions raised in the Paper and will comment only where the issues are directly relevant to our members.

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?

Our members favour objective standards and clearly defined thresholds rather than subjective criteria like proficiency that may be difficult to measure. Furthermore, we question the need to introduce a new concept of "qualified party" when existing regulation already defines similar concepts of "accredited investor" in NI 45-106 and "permitted client" in NI 31-103.

Q3: Should registration as a derivatives dealer be subject to a *de minimis* exemption similar to the exemption adopted by U.S. regulators? Please indicate why such an exemption is appropriate.

Assuming that a new registration requirement is adopted for OTC derivatives, we believe it should be subject to a *de minimis* exemption in order to avoid putting an undue regulatory burden on participants that do not present a systemic risk. It is our view that the de minimis threshold cannot be determined (in addition to the the need for a registration regime for derivatives) until the TR and CCP Clearing data has been collected and assessed.

Q4: Are derivatives dealer, derivatives adviser and LDP the correct registration categories? Should the Committee consider recommending other or additional categories?

As stated above, we do not believe there is any need or requirement for additional categories of registration to be implemented in Canada. To the extent a new regime is adopted, where an IIROC member engages in OTC derivatives activities, OTC derivatives regulation should provide an "equivalent regime" exemption from registration requirement.

Q9: Are the factors listed for determining whether an entity is a LDP appropriate? If not what factors should be considered? What factors should the Committee consider in determining whether an entity, as a result of its derivatives market exposures, could represent a serious adverse risk to the financial stability of Canada or a province or territory of Canada?

As stated in our general comments, we recommend that the need to improve upon the existing registration regime should be assessed based on data gathered form TRs and CCP Clearing. We therefore support the view that the CSA Derivatives Committee should conduct extensive analysis of trade repository data before determining the factors that

should trigger a registration requirement for LDPs. That information will shed light on the microstructure of the market for OTC derivatives and potential sources of systemic risk.

Q10: Is the Committee's proposal to only register derivative dealer representatives where they are dealing with clients or when dealing with counterparties that are non-qualified parties appropriate?

We agree that dealer representatives should only be registered where they are dealing with non-qualified parties.

Q11: Is it appropriate to impose category or class-specific proficiency requirements?

We agree that proficiency requirements should be limited to classes or categories of derivatives that a representative is trading. We believe that it would be difficult to define those requirements by category or class of product in regulations. To the extent a registration regime is adopted, any determination concerning the required proficiencies would have to be subject to significant study and industry consultation.

Q12: Is the proposed approach to establishing proficiency requirements appropriate?

Care must be taken to ensure that proficiency and examination requirements are adapted to the role of the registered individual. For example, directors should not be expected to have the same product specific knowledge as traders. To the extent a registration regime is adopted, any determination concerning the required proficiencies would have to be subject to significant study and industry consultation.

Q13: Is the Committee's proposal to impose a requirement on registrants to "act honestly and in good faith" appropriate?

We do not believe that this requirement is necessary because, in the context of a transaction between counterparties, it already is a contractual obligation.

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.

As stated in our general comments, IIROC Dealer Members should benefit from equivalent regime recognition and not be subject to specific requirements outlined in the Paper.

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.

IIROC members are already subject to business conduct standards similar to those described in 7.2(b)(iii) and, as such, should be exempted from the specific business conduct requirements set out in the Paper.

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.

We recognize the need to protect the interests of non-qualified parties trading with derivatives dealers. However, we believe that neither of the alternatives proposed in the Paper is appropriate.

In the first alternative, we fail to understand who would advise clients in transactions without providing trading facilities. We are not aware of any entity offering such services to retail clients in Canada. Furthermore, how could a dealer ascertain that a client is receiving independent advice? Finally, if such a service existed, it would certainly add significant costs that would be borne by clients.

The second alternative, to have pre-trade disclosure and written acknowledgment that the non-qualified party is electing not to obtain independent advice is simply not practical in many, if not most market conditions. It would add unnecessary delays in the trading process and would inevitably cause many trading opportunities to be missed, resulting in increased risks. Disclosure on a trade-by-trade basis is also completely redundant as most participants would make the same election on all of their trades.

We therefore recommend that written disclosure be provided during the account opening/documentation process and that the non-qualified party be allowed to provide a blanket acknowledgement indicating that they were electing not to obtain independent advice. The same disclosure could also be included on post trade reports.

Q17: Are the recommended requirements appropriate for registrants that are derivatives dealers? If not please explain. Are there any additional regulatory requirements that should apply to registered derivatives dealers?

With regards to KYC requirements, we acknowledge the need to update client information on a periodic basis. We would like clarification however on how ``on a periodic basis`` would be interpreted. Would the frequency be left to the firm? We also submit that the obligation to update KYC information should not apply to clients that have not maintained a position or been active in the past year.

We do not agree that the requirement to update client information "…where the person takes steps to enter into a transaction that is inconsistent with the person's general objectives or is materially inconsistent with their past trading activity" should apply to all cases. We submit that exemption should exist for order-execution only firms.

Conclusion

We reiterate our two main recommendations:

1. We strongly believe that a new registration regime is unnecessary and should therefore not be implemented in Canadian derivatives markets. We therefore recommend that Canadian regulators implement G20 commitments within the existing registration framework. The need for changes or additions to the existing registration regime can be best assessed once other initiatives contemplated in CP 91-401 have been implemented, including Trade Repositories and Central Counterparty Clearing . Furthermore, if and when regulators choose to proceed with the implementation of a new regulatory regime, IIROC regulated firms should be exempt.
2. We ask the Committee to confirm that listed derivatives are excluded from the scope of the Paper.

We welcome the opportunity for an ongoing dialogue with the CSA on this important initiative and would be pleased to discuss this submission should you have any questions.

Best regards,

Richard Morin
Director, Government Relations and Quebec Region
Investment Industry Association of Canada
rmorin@iiac.ca