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John Stevenson
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, Ontario M5H 3S8
E-mail: jstevenson@osc.gov.on.ca

-and-

Me Anne-Marie Beaudoin, Corporate Secretary
Autorite des marches financiers
800, square Victoria, 22e etage, C.P. 246 tour de la Bourse
Montreal, Quebec H4Z 1G3
E-mail: consultation-en-cours@lautorite.qc.ca

Re: CSA Consultation Paper 91-407 Derivatives: Registration

The Portfolio Management Association of Canada ("PMAC"), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to submit the following comments regarding CSA Consultation Paper 91-407 Derivatives: Registration (the "Consultation Paper").

As background, PMAC represents investment management firms registered to do business in Canada as portfolio managers. In addition to this primary registration, some firms are dually registered as investment fund managers and/or exempt market dealers or other registration categories but generally 70% of their income is derived from portfolio manager registration to be members of PMAC. PMAC was established in 1952 and currently represents over 170 investment management firms that manage total assets in excess of \$800 billion (excluding mutual funds assets). Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

General Comments

PMAC supports the regulation of key derivatives market participants. However, we have concerns with a new registration regime being created that will overlap with an already sufficient and robust securities registration regime. Specifically, we do not believe that a new registration category for advisers that is based solely on an asset class is necessary. In our view, just as investment fund managers will continue to be regulated under securities legislation regardless of the assets held by the fund, we believe portfolio managers should be treated equivalently. Derivatives are one of the many types of securities that portfolio managers may include in a client managed portfolio on a discretionary basis to meet a client's investment objectives. We do not believe that a new registration category for advisers should be predicated on the type of assets being advised on as opposed to the established business triggers set out in National Instrument 31-103. For entities that may not otherwise be registered under securities laws, we believe that if such entities advise with respect to derivatives, a registration under securities laws is adequate. If an individual is already registered as an adviser under NI 31-103, there should be no additional registration requirements under a derivatives regime to register. The act of advising on derivatives, in and of itself, in our view is not required to trigger a registration requirement in a separate category and under a separate regime. Particularly, since many of the proposed registration requirements for a derivatives adviser would simply duplicate many of the existing requirements under securities laws.

Set out below are some additional comments on the Consultation Paper. Our comments do not provide responses to each question included in the Consultation Paper but rather we highlight some of the issues we see with the proposals.

Portfolio Managers and the Use of Derivatives

PMAC Members are uniquely positioned in the derivatives space in that many of our Members have no derivatives exposure at all, with some Members having a small exposure and a limited group being somewhat more active. Derivatives are one of several possible types of investments such as equities and fixed income securities that portfolio managers employ to manage their client's assets on a discretionary basis to meet their investment objectives. They are typically used as a compliment to the portfolio management process or for hedging purposes. Portfolio managers, thus advise clients to trade derivatives on a limited basis for portfolios that they manage in accordance with a client's written investment mandate or investment policy statement that forms a part of a contractual agreement with a client and, which is guided by a fiduciary duty owed to such client. In addition, portfolio managers are compensated based on the value of assets under management and not based on derivatives transaction volumes. While the concepts/proposals set out in the Consultation Paper appear to be aimed at derivatives transactions, portfolio managers have ongoing client relationships that are guided by concepts such as know-your-client, know-your-product and suitability. In our view, given the existing regulatory requirements and the nature of the portfolio manager/client relationship, we do not believe it is necessary or appropriate to introduce a registration category that is based on asset type for advisers.

Notwithstanding this view, we do strongly believe that any derivatives registration requirements, to the degree practical, should be harmonized across all CSA jurisdictions and impose requirements that will not result in duplication with securities laws and unnecessary regulatory burden.

Harmonization

Despite our objection to a new derivatives adviser category of registration, a derivatives registration regime in Canada should be founded on set of rules that are harmonized across provinces and territories. The Consultation Paper does not confirm that a derivatives regime would fall under a national instrument and given the various current differences provincially in this area, we believe greater certainty and clarity is needed. Regulatory coordination and cooperation, both within Canada and between Canadian and global authorities, is needed to clarify the appropriate scope of regulation. Canada also needs to be aligned with other G20 countries in order to maintain our ability to advise on the trading of derivatives internationally and avoid the undesirable scenario of advising under a fragmented regime.

Definition of "Derivatives"

We note that the Consultation Paper does not provide a definition of "derivatives" and it remains unclear as to what is contemplated to be included and subject to the registration regime. The Consultation Paper does not define derivatives products and currently, there is no single, harmonized definition of derivatives available across the CSA. Without such a definition, the registration regime outlined in the Consultation Paper has the potential to create an uneven and potentially confusing playing field for firms.

We note that CSA Consultation Paper 91-301 - *Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting* provides the Committee's recommendations on the type of instruments that will be considered derivatives as it relates to trade reporting as a source of insight into what types of instruments that the Committee may recommend to be considered derivatives for the purposes of triggering registration as a derivatives dealer or adviser. More recently, we note the publication of proposed OSC Rule 91-506 Derivatives: Product Determination which was published on June 6, 2013. As a preliminary observation, we are pleased that currency exchange contracts will be excluded from the definition of "derivatives". However, foreign exchange forwards, swaps and options should also excluded from definition used in Rule 91-506.

The importance of certainty as to what will be considered to be a derivative is of crucial importance and will inform many of the comments/concerns provided by stakeholders through the CSA consultation process. Therefore, we urge the CSA to consider carefully the scope of the definition of "derivatives".

Concept of "Qualified Parties"

We recommend there be a "qualified party" exemption for advisers. We believe the concept of "qualified parties" should be aligned with similar existing concepts. For instance, the CSA should consider incorporating existing definitions of "accredited investor" under NI 45-106, "permitted client" under NI 31-103 and "accredited counterparty" under *Quebec Derivatives Act* into any new derivatives registration regime. Portfolio managers that manage derivatives portfolios for "qualified parties" should be exempt from registration.

De Minimus Threshold

The Consultation Paper does not make reference to any sort of *de minimus* threshold that would trigger the registration requirement. We think there is merit in exploring the approach adopted by U.S. regulators to registration as a derivatives dealer, which provides a *de minimus* exemption. While participants in the derivatives market should be subject to the same

protections regardless of the size or the total derivatives exposure of the dealer or adviser, a *de minimus* exemption may be appropriate in certain cases.

Registration Requirements

We agree that persons carrying on the business of "trading" in derivatives or holding themselves out to be carrying on that business, should be regulated. Similarly, advising in derivatives should and is, in our view, already regulated under the current securities regulatory regime. While acknowledging that the derivatives markets are different from securities markets, as an overall observation, we believe that the registration requirements contemplated in the Consultation Paper should tie to the existing registration concepts in NI 31-103. This will allow for a more consistent approach and application to all types of market participants and reduce inefficiencies in duplicative roles and other requirements related to compliance. We recommend that the proposed registration requirements for a derivatives adviser that are not currently included in NI 31-103, such as the requirement to have a Chief Risk Officer, be considered for inclusion in future amendments to NI 31-103.

Regarding proficiency, we agree that minimum levels of proficiency should be stipulated for persons carrying on the business of trading and/or advising others in relation to derivatives. However, we see some issues with the duplication in a derivatives registration regime to what is already required under NI 31-103. For instance, if a firm is required to register under the derivatives framework, then the Consultation Paper contemplates firms having to have two UDPs, two capital calculations etc. This becomes increasingly onerous for smaller firms who may be caught if there is no *de minimus* threshold or otherwise available exemption. Similarly, the concept of a Chief Risk Officer who would report to the "risk committee" of the board of directors assumes that a firm has a risk committee in place. We identify below some additional concerns with certain concepts included in the Consultation Paper:

Fund registration -- We have concerns with the concept that a "fund" itself would need to be registered as a derivatives dealer. What objective would this achieve? In our view, this is an odd outcome and inconsistent with the current securities regime.

Proficiency requirements -- We note that there is very little detail in the Consultation Paper on the proficiency requirements. We would expect that proficiency requirements mirror current principles based concepts of proficiency under NI 31-103 (in addition to specified exams) with the specifications that the proficiency relate specifically to derivatives. We agree that proficiency requirements are intended to ensure that individuals representing registrants understand the fundamentals of the markets in which they trade or advise in and the regulatory requirements relevant to their activities. However, it is not clear to us that minimum proficiency requirements should be based on the specific classes or categories of derivatives that a representative is trading in or providing advice on. As this is not currently required in the securities regime, it is not entirely clear how this would be accomplished in the derivatives world. Meeting proficiency requirements through work experience is likely the most common way to meet proficiency requirements. Derivatives registrants that are also securities registrants will be required to ensure that their representatives meet proficiency requirements applicable to both securities registrants and derivatives registrants. Under the know-your-product (KYP) and suitability rules this is already contemplated under NI 31-103.

Minimal Capital Requirements -- We agree that registrants be required to maintain minimum specified levels of capital. These requirements are intended to ensure the solvency of registrants, with the intention of reducing the likelihood that they cannot meet their ongoing obligations under derivatives contracts. As many potential derivatives registrants are already subject to capital regulation by various regulatory bodies, we agree that where such

requirements are substantially equivalent, those requirements will continue to apply and those entities will be exempt from the CSA's capital requirements. We support this approach and do not agree with having separate capital requirements under a derivatives registration regime. We understand that further recommendations relating to minimum capital requirements will be provided in a future paper.

Concept of UDP and Chief Risk Officer (CRO) -- We note that these roles as contemplated in the Consultation Paper are not consistent with NI 31-103. For example, the CRO would need to report to a risk committee of the Board (smaller firms won't have this) annually and file this report with the CSA (not a current requirement for CCO report to the board). It is not clear what the purpose of filing an annual compliance and risk management report with regulators would serve. Such reports would be available to regulators upon request. In our view, requiring such reports to be reviewed annually by the firm's board of director's is sufficient.

Exemptions from Registration

The Consultation Paper specifically mentions an exemption for foreign registered derivatives dealers and advisers. These entities would be exempt from having to comply with Canadian requirements but would still be required to register. In our view, they should be exempt from registration as well. In this regard, we believe that exemptions should be made consistent with NI 31-103 and that a derivatives regime should not depart from the existing securities framework in place as there is already a double regime between the CSA and OSC (OSC Rule 35-502 Non-resident Advisers) for such exemptions.

Clarification Issues

There are a number of issues that the Consultation Paper either does not address or where further clarity is required. For instance, how this regime will impact foreign affiliates servicing Canadian funds. With regard to the treatment of pooled funds, it remains unclear as to whether pooled funds would need to be registered. There also remains many questions surrounding the definition of derivatives. Having a separate registration for futures or listed options would, in our view, create even more problems. Finally, we note that discussion on a timeline for a derivatives registration regime was not included in the Consultation Paper nor a discussion regarding registration fees.

Conclusion

As indicated above, we do not believe that a new derivatives adviser registration category is necessary given the current securities registration requirements and safeguards that such rules provide. We acknowledge that there remains much work to be done in the area of derivatives regulation and given the number of moving parts under consideration, we believe it is imperative that the CSA continue to consider all of the issues raised by market participants/stakeholders and maintain meaningful consultations with those it is seeking to regulate.

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If you have any questions regarding the comments set out above and/or any of our recommendations, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Julie Cordeiro at (416) 504-1118.

Yours truly,

**PORFOLIO MANAGEMENT ASSOCIATION OF CANADA**

*K.A. Walmsley*

Katie Walmsley  
President, PMAC

*Scott Mahaffy*

Scott Mahaffy  
Chair, Industry, Regulation & Tax Committee  
Vice President Legal, MFS McLean Budden Limited



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