



**Futures Industry Association**

2001 Pennsylvania Ave. NW  
Suite 600  
Washington, DC 20006-1823

202.466.5460  
202.296.3184 fax  
www.futuresindustry.org

**BY COURIER AND EMAIL**

August 25, 2006

**Autorité des marchés financiers**

800, square Victoria, 22<sup>e</sup> étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

**Attention: Ms. Anne-Marie Beaudoin, Director, Secretariat**

Dear Sirs/Mesdames:

**Re: Regulation of Derivatives Markets in Québec**

The Futures Industry Association (“**FIA**”) is pleased to provide this comment letter to the Autorité des marchés financiers (“**AMF**”) with respect to the AMF’s report entitled *Regulation of Derivatives Markets in Québec* dated May 1, 2006 (“**Report**”).

The FIA is a principal spokesman for the commodity futures and options industry. Our regular membership is comprised of approximately 40 of the largest futures commission merchants (“**FCMs**”) in the United States. Among our approximately 150 associate members are representatives of virtually all other segments of the futures industry, both national and international, including US and international exchanges, banks, legal and accounting firms, introducing brokers, commodity trading advisors (“**CTAs**”), commodity pool operators and other market participants, and information and equipment providers.

The FIA supports the AMF’s recent initiative to address the regulation of derivatives and futures in Québec as regulatory certainty in the derivatives and futures markets is crucial to the efficient operation of these markets in Québec for both domestic and international industry participants.

In our view, the goals of such a regulatory initiative should include:

- to provide institutional investors with rational access to international products and markets, including through reasonable registration exemptions for non-Canadian FCMs and CTAs;
- to provide more trading opportunities for customers;
- to facilitate innovative electronic trading techniques;
- to promote competition among exchanges world-wide; and

- to foster international regulatory cooperation.

The FIA comments relate primarily to the AMF's proposed regulation of non-Canadian FCMs and CTAs and exemptions from such requirements; the proposed requirements applicable to non-Canadian exchanges and the accessibility of non-Canadian exchange-traded futures and options for Québec investors; and, the proposed regulation of associations that regulate their members.

For the reasons set forth below, the FIA submits that:

- (a) the AMF should not impose a registration requirement on non-Canadian FCMs that trade only with "accredited investors" and should broaden the list of exempt clients for CTAs;
- (b) Québec investors should have access to products that trade on regulated international (non-Canadian) markets without the need for the exchanges to register or the products to be qualified in Québec;
- (c) the AMF should not impose recognition or authorization requirements on international (non-Canadian) associations that regulate the activities of their members in international markets;
- (d) as a general matter, a "core principles" approach to regulation is the preferred approach, especially relating to the self-certification of new products; and
- (e) the AMF should adopt a "definitional" approach to derivatives, rather than specifying particular products; however, this approach must be limited to avoid regulatory overlap and uncertainty.

In particular, the FIA strongly urges the AMF to maintain the status quo with respect to non-Canadian FCMs that trade futures and options with Québec institutional investors. The FIA is not aware of any regulatory problems that have arisen in Québec under the existing institutional exemptions.

## **REGISTRATION REQUIREMENTS FOR DEALERS AND ADVISERS**

The FIA urges the AMF to maintain the registration exemptions available to non-Canadian FCMs and CTAs that desire to trade, advise or provide access to international derivatives markets to Québec accredited investors.

The FIA understands that Canadian-resident persons or companies desiring to trade or advise with respect to derivatives are presently required to comply with licensing, proficiency and compliance requirements of the Investment Dealers Association of Canada ("IDA") and the Bourse de Montréal ("MX"). The FIA notes that the AMF recommends maintaining the current registration regime for dealers and advisers who desire to trade or advise with respect to derivatives, which regime does not permit the registration of non-Canadian dealers or advisers.

The FIA understands that under the current regulatory regime in Québec, non-Canadian FCMs are not required to register as dealers in Québec if such FCMs limit their trading activity to

trading with “accredited investors” as defined in National Instrument 45-106 – *Prospectus and Registration Exemptions* (“**NI 45-106**”). In addition, non-Canadian CTAs are not required to register as advisers if their advising activities are limited to advising those Québec investors enumerated in Section 194.2 of the Securities Regulation (R.R.Q., 1981, c. V-1.1, r. 1). We recommend that the AMF retain the exemption for FCMs and broaden the exemption for CTAs to advise accredited investors. In particular, we support the AMF’s intention, “... to propose legal exemptions based on the type of person that trades in such products rather than the products themselves...”<sup>1</sup>

We note that the AMF states in the Report that the preferred approach with respect to an extended definition of “derivatives” is based on the Australian rules. In Australia, certain foreign financial service providers are granted relief from licensing requirements; however, such relief is based on requirements to make certain filings and submit documentation to the Australian authorities. It is the FIA’s view that such filings are not necessary to protect investors in the institutional market and present an unnecessary additional layer of administrative requirements. The FIA encourages the AMF to maintain exemptions for trading with or advising institutional investors in Québec without requiring dealers and advisers to register or file documentation with the AMF.

Furthermore, the FIA recommends that the AMF work towards harmonizing the registration regime across Canada for both domestic and non-Canadian firms. The current regulatory framework in Canada applicable to non-Canadian dealers and advisers is fragmented and with inconsistent provincial requirements which add to the regulatory burdens and costs for international firms wishing to participate in the Québec and Canadian markets.

## **REGULATION OF FOREIGN EXCHANGES**

The FIA understands that the proposed Derivatives Act would govern “regulated entities” entities such as exchanges, clearing houses and membership associations. The FIA understands that the AMF is prepared to authorize foreign-based exchanges in accordance with *Proposed Policy Statement Respecting the Authorization of Foreign-Based Exchanges*<sup>2</sup> (“**Policy Statement**”).

The AMF recommends that “[r]ecognition or authorization of derivatives exchanges and clearing houses should be a legal requirement”<sup>3</sup>. Specifically, the AMF recommends that the proposed Derivatives Act contain a provision, similar to one in the *Securities Act* (Québec) (“**QSA**”) that, “[n]o legal person, partnership or other entity may carry on derivatives trading or clearing activities in Québec without the authorization of the [AMF].”<sup>4</sup>

Pursuant to the Policy Statement, the AMF proposes to require foreign-based exchanges to file an application (made on Form 21-101A1) in accordance with the requirements set out in NI 21-101<sup>5</sup>. Such requirements are substantive and, in the FIA’s view, an impediment to non-Canadian

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<sup>1</sup> Report at p. 31.

<sup>2</sup> *Supplément à la Section valeurs Mobilières du Bulletin de l’Autorité des marchés financiers*, 2004-11-19, Volume 1, No. 42.

<sup>3</sup> Report at p. 39

<sup>4</sup> Report at p. 40.

<sup>5</sup> Policy Statement, p. 2.

exchanges doing business in Québec. Furthermore, the AMF proposes to impose certain conditions of compliance on an applicant such as, filing annual reports and financial statements; updating material amendments to the laws or regulations governing its activities; updating amendments to internal by-laws; advising on changes in its right to operate; and, providing notice of any situation that could impact its financial ability<sup>6</sup>. The Policy Statement also sets out other requirements applicable to applicants.

The FIA believes that such substantive review and filing requirements are unnecessary and burdensome as these entities are subject to regulation in their home jurisdictions. Thus, the FIA does not believe that additional review and oversight by the AMF would provide additional investor protection.

We understand that the application of the proposed provision is limited to trading and clearing activities conducted “in Québec”, however, it is unclear whether such requirement will be applicable to non-Canadian exchanges, clearing houses and associations. In particular, the FIA urges the AMF to make clear in the proposed Derivatives Act that the fact that derivatives contracts listed on a non-Canadian exchange may be sold in Québec to Québec residents through Canadian dealers or advisers that are subject to registration and oversight in Québec, or through FCMs and CTAs that are otherwise exempt from the registration requirement, does not result in the conclusion that the non-Canadian exchange itself is carrying on trading activities in Québec which would require it to be recognized or authorized under Section 169 of the QSA. Furthermore, the FIA submits that the AMF should also make clear that futures and options products that trade on a non-Canadian exchange are not required to be reviewed, accepted or approved by the AMF prior to their trading in Québec.

We encourage the AMF to review the regulation of non-Canadian exchanges in light of changes in the electronic trading landscape. In particular, we would encourage the AMF to review concepts such as “carrying on business in Québec” and “jurisdiction” with a view to the reality of today’s electronic marketplaces. Historically, under U.S. rules, an exchange’s location was determined by looking at the location of the exchange’s trading floor as well as where it was legally-organized, its self-regulation was conducted or managed and its government regulation was authorized. As electronic trading systems have largely supplanted trading floors worldwide, linking an exchange’s location to where its orders are matched is now more of a challenge. However, many international (non-Canadian) exchanges are legally organized and incorporated outside of Canada, are managed by self-regulators outside of Canada and are subject to meaningful government regulatory regimes outside of Canada. In these circumstances, FIA believes these exchanges should not be regulated by the AMF in addition to the home jurisdiction so long as customers trade on these markets through, or as authorized by, regulated or exempt intermediaries.

Consistent with this view, the FIA believes that the AMF should recognize home country regulation and not regulate based on factors such as Canadian customer volume, exchange server placement, or the “nationalizing” of particular futures contracts. Each of these factors could disadvantage Canadian customers, decrease exchange competition and add substantial costs.

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<sup>6</sup> Policy Statement, p. 6.

FIA submits that it is not necessary for the AMF to separately regulate non-Canadian exchanges that are regulated by foreign regulators, even if such regulations differ from those of the AMF.

The FIA notes that in British Columbia, Alberta, Saskatchewan and certain other provinces, foreign exchanges and clearing houses are recognized by order or other document without the need to provide, for example, financial statements, rules and contract specifications. Such entities are granted recognition based upon the regulatory approval status in their home jurisdictions. The FIA believes that it is unnecessary for the AMF to conduct an extensive and prolonged review of such entities as they are regulated in their home jurisdiction. We urge the AMF to recognize such entities as a matter of course based upon standing in their home jurisdiction. It is our understanding that no foreign-based exchange has applied under NI 21-101 for approval as an exchange in Canada to date although ICE Futures has applied to the Ontario Securities Commission for an exemption from recognition as a stock exchange and registration as a commodity futures exchange and such application has become the subject of a “Notice and Request for Comment – ICE Futures’ Application for Exemption from Recognition and Registration as an Exchange” – (2006) 29 OSCB – July 21, 2006.

In addition, the AMF should clarify when a foreign exchange or clearing house is conducting business or operating a market in Québec. Such entities are confronted with regulatory uncertainty in Québec because there is no clear guidance as to when they are subject to regulation.

#### **REGULATION OF FOREIGN “ASSOCIATIONS”**

The FIA believes that the AMF’s reference to “membership associations” in the definition of “regulated entities” in the Report is vague and appears to include foreign SROs such as the National Association of Securities Dealers (“NASD”), the National Futures Association (“NFA”) and other such international associations. Furthermore, it appears that the AMF proposes to regulate such SROs. The FIA submits that there is no need for the AMF to regulate these SROs in Québec since they are subject to government oversight in their home jurisdiction.

#### **“CORE PRINCIPLES” REGULATORY APPROACH**

As a general matter, the FIA supports a regulatory approach based on “core principles”, especially with respect to the self-certification of new products. As noted by the AMF in the Report, principles-based regulation is becoming increasingly accepted by regulators and market growth and innovation by market participants require a regulatory process that is able to keep pace with these changes.

The FIA agrees with the AMF that regulatory principles should be framed so as to be adaptable to the evolution of the markets and such flexibility is needed to allow for innovation without the delays inherent in regulatory amendments.<sup>7</sup>

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<sup>7</sup> Report at pp. 26-27.

## **DEFINITION OF “DERIVATIVES”**

The FIA supports the approach of defining “derivatives” by describing the features of a derivative rather than compiling a detailed list of such instruments; however, the FIA is concerned that such definition not be an “extended” or “all-inclusive” definition so as to avoid regulatory overlap and uncertainty and cover only those products and investors that the AMF intends to regulate under any new derivatives legislation.

The FIA supports the “definitional” approach because it will provide flexibility from a regulatory standpoint and will facilitate the introduction of new products and would be generally consistent with a core principles approach.

The FIA submits that the AMF should consider a narrower definition of derivatives to clearly avoid regulatory uncertainty associated with overlapping securities, banking or other regulations and to avoid, for example, “prospectus” issues in the futures markets.

## **PUBLIC AVAILABILITY OF COMMENT LETTERS**

We are aware that the AMF may, but does not systematically publish comment letters on its website in response to AMF requests for comments. We would note that this appears contrary to the general practice of most regulators and, in connection with the Report, our view is that it is important for the AMF to publish all submissions (other than submissions expressly made on a confidential basis) so that the FIA’s position is available as a matter of public record and the FIA has the opportunity to understand and review the comments expressed by other commenters. The FIA is of the view that the publication of submissions is important to an open and transparent legislative process.

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Should you have any questions or comments, do not hesitate to contact the FIA. The Executive Committee of our Law and Compliance Division would be pleased to work with you as you continue to address the regulation of derivatives markets and intermediaries.

Respectfully,

*“John M. Damgard”*

John M. Damgard  
President