

**THE OPTIONS CLEARING CORPORATION**

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**BY E-MAIL AND COURIER**

**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**

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

Dear Sirs/Mesdames:

The Options Clearing Corporation (“OCC”) welcomes the opportunity to provide this comment letter to the Autorité des marchés financiers (“AMF”) with respect to the AMF’s proposal entitled *Proposed Derivatives Framework* dated August 10, 2007 (“**Proposed Derivatives Framework**”) regarding the proposed derivatives legislation (“**Proposed Derivatives Act**”).

**SUMMARY OF OCC SUBMISSION**

By letter dated August 25, 2006 (“**OCC Comment Letter**”), OCC previously commented on the AMF’s report entitled *Regulation of Derivatives Markets in Québec* dated May 1, 2006 (“**Report**”). The OCC Comment Letter raised the following four main concerns with respect to OCC specifically and clearing houses in general:

- (i) The AMF should make clear that provisions requiring authorization or recognition of foreign derivatives clearing houses would not obligate a clearing house that has no physical presence in Québec and does not clear transactions in Canadian exchange traded derivatives to be authorized or recognized by the AMF;
- (ii) The role of a foreign derivatives clearing house as the nominal “issuer” of derivatives contracts that are sold in Québec through Québec-

licensed brokers should not, in and of itself, require authorization or recognition;

- (iii) The AMF should defer to the oversight of a foreign clearing house's home regulatory authority where a foreign clearing house is subject to comprehensive regulation in its home jurisdiction; and
- (iv) The AMF should not impose a "prospectus" requirement on either foreign or domestic derivative clearing houses.

OCC wishes to reiterate its concerns in connection with the Proposed Derivatives Framework and specifically address some specific concerns about the AMF's approach to the regulation of derivatives.

#### SUMMARY OF AMF RESPONSES

OCC notes that the AMF responded directly to one point raised by OCC in the document entitled *Responses to Public Comments – Oversight of Derivatives Markets in Québec* dated February 2, 2007. When considering whether a foreign clearing house would be required to be authorized or recognized the AMF stated:

##### *“Our response to the OCC*

*It is necessary to be authorized in Quebec if the recognized entity carries on activity in Quebec. This determination is made on a case-by-case basis. As regards exemptions versus authorization, the AMF is in favour of granting authorizations rather than authorization exemptions, given the flexible framework provided for under our legislation whereby authorization conditions may be adjusted.*

*We plan to implement the approach set out in the Policy Statement respecting the authorization of foreign-based exchanges with regard to foreign clearing houses already authorized or recognized by the regulatory authority in their home jurisdiction if they apply for authorization in Quebec.”*

We requested clarification as to the circumstances under which the AMF would consider a foreign clearing house to be carrying on business in Quebec. The AMF has not provided any additional guidance by its response.

Additionally, we note that, when responding to another comment, the AMF stated that:

*"In our opinion, to properly fulfill our mission of protecting investors, we must require a minimum of disclosure documents from entities that seek to carry on activities in Québec. Our requirements for the filing of documents have not prevented foreign exchanges from applying for authorization to conduct exchange activities in Québec. These include the London Stock Exchange and Eurex U.S.*

*The expression "carry on activities in Québec" is not defined in our legislation, and this was a voluntary omission, in particular given the speed of technological developments. For example, an entity may currently carry on exchange activities in a jurisdiction without operating physical installations there, but do so solely through an electronic trading platform. Determining the jurisdiction of activities is a continually evolving issue and one for which setting parameters could prove to be more problematic than beneficial."*

We believe that the AMF should provide guidance as to when a clearing house will be required to seek authorization or recognition. The very "speed of technological developments" that the AMF cites as a reason for not "setting parameters" in its rule-making creates even greater ambiguity in "[d]etermining the jurisdiction of activities" for those whose activities are potentially subject to regulation by the AMF than it does for the AMF itself. While we understand the desire of the AMF to take a case-by-case approach to these issues, we are hopeful that the AMF will be forthcoming in giving case-by-case guidance where requested for new activities and will in any event not use the flexibility of the regulatory framework to regulate activities that were previously unregulated by the AMF without adverse consequences to the public interest.

#### **OCC COMMENTS TO PROPOSAL**

##### **1. Clearing Activities "in Québec"**

Pursuant to section 17 of the Proposed Derivatives Act, "[n]o person may carry on the activities of a regulated entity *in Québec* without being recognized by the Authority" [*emphasis added*]. Section 16 of the Proposed Derivatives Act defines "regulated entities" to include an exchange, a clearing house, a regulation services provider and a self-regulatory organization. OCC wishes to reiterate that it has never been viewed as carrying on activities in Québec and therefore, OCC should

not be so considered under the Proposed Derivatives Act. While we understand the AMF's position to review a foreign clearing house's activities and connections to Québec on a case-by-case basis, we presume that the AMF is not intending to regulate foreign clearing activities which have not been the subject of regulation in the past and change what the AMF considers to be carrying on a business in Québec.

## 2. *Clearing Activities vs. Issuing Activities*

As noted in the OCC Comment Letter, "a derivatives clearing house such as OCC has an additional role as the "issuer" or obligor with respect to derivatives contracts that it clears. The AMF has at least tacitly distinguished between these two functions in OCC's case."<sup>1</sup> We believe that the AMF should continue to make a distinction between OCC's clearing activities and those activities it undertakes as the nominal issuer of contracts.

Under section 96 of the Proposed Derivatives Act, OCC believes that the AMF has continued to make this distinction by identifying two separate categories of persons that are permitted to make an offer to the public of exchange-traded or OTC derivatives: (i) a person who is a recognized regulated entity, and (ii) a person who is qualified by the AMF, in accordance with the conditions prescribed by regulation. OCC would fall within the second category of persons who are permitted to offer exchange-traded or OTC derivatives to the public since OCC is not required to seek authorization or recognition under section 16 of the Proposed Derivatives Act. Under section 284 of the Proposed Derivatives Act, OCC would maintain its previous qualification as "[t]he qualifications granted under section 67 of the Securities Act shall remain in effect notwithstanding their replacement by this proposed legislation." Thus, the AMF has previously qualified OCC with respect to certain products, and that qualification would continue under the Proposed Derivatives Act.

Notwithstanding the foregoing, we believe that a clearing house should not in any event be characterized as making a "public offer" of derivatives merely by reason of its clearing function, which includes its nominal role as issuer of listed options. OCC is not a conventional issuer of securities in that it does not retain the proceeds of the options it clears, nor do purchasers of OCC-issued options acquire any interest in, or look to the earnings of, OCC's business. Rather, OCC simply

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<sup>1</sup> OCC Comment Letter, p. 5.

guarantees the performance obligations incurred by persons who sell or “write” options and holds collateral deposited by them to secure those obligations.

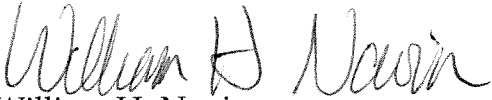
Even if the AMF should deem OCC to be making a “public offer” of derivatives, the AMF should consider that the U.S. Securities and Exchange Commission has recognized that, in its role as nominal issuer, OCC is fundamentally different from a conventional issuer of securities. A purchaser of an exchange-traded derivatives contract does not typically make an investment decision based on the nominal issuer but rather the terms of the derivatives contract. As a result, information about the clearing house’s business, its officers and directors, and its financial statements, is less relevant to investors in derivatives. In derivative transactions, the investment risk is determined primarily by the market performance of the underlying security rather than the performance of the clearing agency. Furthermore, unlike a conventional issuer, a registered clearing agency does not receive the proceeds from sales of the derivatives that it issues.

3. *Regulatory Oversight – Home Jurisdiction*

OCC is of the view that its clearing house activities have not been and should not be considered to constitute the carrying on of business in Quebec. Nonetheless, OCC submits that if it does become subject to specific oversight by the AMF because it is deemed to be carrying on a business in Quebec, the AMF should defer to the regulatory oversight of OCC by the SEC and CFTC in the United States and not impose additional, duplicative and unnecessary regulations.

Should you have any questions or comments do not hesitate to contact me.

Respectfully,

  
William H. Navin