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September 1, 2017

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Re: Comments with respect to Proposed National Instrument 93-101 *Derivatives: Business Conduct* and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct*

The International Swaps and Derivatives Association, Inc. (***ISDA***[1]) appreciates the opportunity to provide comments with respect to Proposed National Instrument 93-101 *Derivatives: Business*

[1]Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members comprise a broad range of

Conduct (the ***Instrument***) and Proposed Companion Policy 93-101CP *Derivatives: Business Conduct* (the ***CP*** and, collectively with the Instrument, the ***Proposed Rule***). The Proposed Rule was published by the Canadian Securities Administrators (***CSA***) on April 4, 2017 and contains the CSA Derivatives Committee's proposal for a harmonized business conduct regime for derivatives across Canada.

ISDA has been actively engaged for a number of years with providing input on regulatory reforms impacting derivatives in major jurisdictions globally, including Canada. ISDA commends the CSA Derivatives Committee for its careful consideration of the issues addressed by the Proposed Rule and welcomes further dialogue with the Committee as it considers the comments and feedback on the Proposed Rule.

PART I - SPECIFIC FEEDBACK ON CSA QUESTIONS

In the CSA Notice and Request for comment, the CSA requested feedback on a number of specific issues. We have set out our responses to the CSA's specific questions below.

1. Definition of "eligible derivatives party"

As currently drafted, the definition of "eligible derivatives party" is generally similar to the definition of "permitted client" in National Instrument 31-103, with a few modifications to reflect the different nature of derivatives markets and participants. Do you agree this is the appropriate definition for this term? Are there additional categories that we should consider including, or categories that we should consider removing from this definition?

Notwithstanding differences between the securities and derivatives markets, ISDA believes that the definition of eligible derivatives party (***EDP***) should include all of the entities that qualify as "permitted clients" under National Instrument 31-103. The derivatives industry will face an enormous compliance burden if existing disclosures and representations by clients regarding their "permitted client" status cannot be leveraged to determine EDP status under the Proposed Rule. From an investor protection standpoint, we do not believe that potential compliance burden is warranted. If an entity is eligible to participate in the exempt securities market, it does not need the full set of disclosures and protections contemplated under the Proposed Rule for non-EDPs. An investor that is sophisticated enough to purchase a principal-at-risk note without a prospectus is, in our view, sophisticated enough to enter into a derivatives transaction as an EDP. For many market participants, derivatives are risk management products (and not investments) which carry less risk of loss than certain securities purchased in the exempt securities markets. Also, given that they usually have an ongoing credit relationship with their derivatives counterparties, derivatives dealers have an extra incentive to appropriately assess and manage risk with their derivatives counterparties (especially regarding their ability to pay); this is not true in the exempt securities market where dealers are not exposed to the investor's credit risk on an ongoing basis.

derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

Given the existing definitions of "accredited investor" for prospectus disclosures under National Instrument 45-106 and "permitted client" under National Instrument 31-103, a different definition for EDPs would result in market participants trading prospectus exempt securities and derivatives having to analyze and give representations with respect to three separate definitions. Participants in the global derivatives markets have incurred significant costs in recent years overhauling their onboarding procedures and reference data systems to classify counterparties under the many different rule sets and related definitions implemented as part of the G20 reform agenda (including, most recently, in connection with new rules for margin for uncleared derivatives). Unless dealers and advisers are able to rely on existing representations and disclosures regarding their clients' "permitted client" status, a large scale outreach effort will be required to determine the EDP status of all counterparties in order to implement the Proposed Rule. ISDA submits that no compelling policy reason has been identified which would justify imposing such a significant compliance burden on the derivatives markets in Canada.

ISDA also believes the EDP definition should include a category for hedgers (similar to the hedger category in the definition of "accredited counterparty" under the *Derivatives Act* (Quebec)). Given the additional compliance burden associated with dealing with non-EDPs, it is possible that dealers will not transact with hedgers if they do not qualify as EDPs. In our view, parties entering into OTC derivatives for hedging purposes do not require the additional disclosures and protections contemplated in the Proposed Rule primarily because such parties are using derivatives as a risk mitigation tool. A definition of EDP that does not include hedgers could ultimately harm Canadian hedgers by effectively forcing them out of the derivatives market or by placing them at a disadvantage from a pricing and liquidity perspective.

Should an individual qualify as an eligible derivatives party or should individuals always benefit from market conduct protections available to persons that are not eligible derivatives parties?

ISDA supports the inclusion of individuals in the definition of EDP; we strongly believe that individuals who meet the financial thresholds in paragraph (o) of the permitted client definition and are able to participate in the exempt securities market should also be treated as EDPs for purposes of the Proposed Rule. As discussed below, we also believe such individuals should qualify as EDPs without the need for additional written representations regarding knowledge and experience.

The Proposed Rule would require individuals that qualify as EDPs to waive in writing the second tier of requirements under the Proposed Rule in order for those second tier requirements not to apply. ISDA submits that such a waiver is not necessary and that individuals that are EDPs should automatically be exempt from the second tier requirements similar to every other category of EDP. In the alternative, if the CSA decide to retain this waiver requirement in the final rule, we request that the requirement to obtain a new waiver from the individual every 365 days be eliminated, and that the onus be placed on the counterparty to revoke the waiver in that circumstance (as opposed to dealers and advisers having to do an annual outreach to all counterparties in order for waivers to be renewed).

2. Alternative definition of "eligible derivatives party"

Please comment on whether it would be appropriate to use the definition of "institutional client" proposed in the April 28, 2016 CSA Consultation Paper 33-404 as the basis for definition of "eligible derivatives party" in the Proposed Instrument.

ISDA believes that the "institutional client" definition proposed in CSA Consultation Paper 33-404 should not form the basis for the EDP definition. The exclusion of individuals and the use of a higher financial threshold in the "institutional client" definition would create unnecessary inconsistency in the regulation of securities and derivatives markets. Furthermore, as explained above, the exclusion of hedgers as a category of EDPs would be detrimental to this important group of market participants and would create an inconsistency with "accredited counterparty" definition under the *Derivatives Act* (Quebec).

With respect to the definition of EDP proposed in the Proposed Rule, we request that the CSA reconsider the $25 million net asset threshold in paragraph (m)(ii) of that definition. As noted above, dealers generally have counterparty credit exposure when they enter into derivatives; as a result, dealers carefully assess their counterparty's ability to perform its obligations under any derivatives transactions. We respectfully submit that many sophisticated entities with less than $25 million in net assets should be eligible to transact in derivatives as EDPs under the Proposed Rule. As opposed to increasing the financial threshold, ISDA would ask the CSA to consider lowering the threshold in paragraph (m)(ii) of the EDP definition to $10,000,000. This would protect a significant segment of the Canadian derivatives market participants from ultimately bearing the cost of additional regulatory burdens that compliance with provisions applicable to non-EDPs would require. We also wish to point out that this approach would be consistent with the "eligible contract participant" definition under the US *Commodity Exchange Act* which uses a USD $10,000,000 total asset test and would thus ensure Canadian market participants are not placed at a disadvantage in comparison to their counterparts in the United States.

3. Knowledge and experience requirements in clauses (m) and (n) of the definition of "eligible derivatives party"

Clauses (m) and (n) of the definition of "eligible derivatives party" provide that a person or company may be an eligible derivatives party if they have represented in writing that they have the requisite knowledge and experience to evaluate, among other things, "the characteristics of the derivatives to be transacted". The corresponding section of the companion policy notes that "some people or companies may only have the requisite knowledge and experience pertaining to derivatives of a certain asset class or product type".

While we appreciate the investor protection objective of the CSA, we respectfully submit that the requirement for written representations regarding requisite knowledge and experience in paragraphs (m) and (n) of the EDP definition is unnecessary and has the unintended effect of disadvantaging sophisticated derivatives parties that currently benefit from participation in the derivatives market. As is the case currently in the exempt securities market, we believe financial thresholds are sufficient to identify derivatives parties who are not in need of extra protections, whether individuals or not, and who have sufficient financial resources to purchase professional advice (where necessary) or are otherwise sophisticated parties that can independently assess their risks and make their own judgments regarding their derivatives transactions. As noted above, requiring such written representations would deviate from the existing “permitted client” definition in a way that would require firms to canvass their full client population to ascertain EDP status (as opposed to relying on existing “permitted client” representations that firms have already obtained). In our view, this would have the unintended effect of imposing a significant burden on both dealers and other market participants and would not provide derivatives parties with any meaningful benefit given that the financial resources test provides a sufficient and objective measure of sophistication, as evidenced by its current use in securities markets and in the US derivatives market.

In addition to obtaining written representations, the CP would require firms to assess the reasonableness of relying on a derivative party’s representations regarding their knowledge and experience. In our view, this creates unnecessary ambiguity around the determination of a derivatives party’s EDP status. If the requirement to obtain such representations is retained by the CSA in the final definition of EDP, we submit that derivatives firms should be able to rely on those representations absent having any basis or grounds to believe the representations are false. We believe it is unduly burdensome to impose an affirmative obligation on dealers and advisers to assess the reasonableness of counterparty representations absent a basis or grounds for believing the representations are not true.

If a person or company only has the knowledge or experience to evaluate a specific type of derivative (for example a commodity derivative), should they be limited to being an eligible derivatives party for that type of derivative or should they be considered to be an eligible derivatives party for all types of derivatives? Is it practical for a derivatives dealer or adviser to make the eligible derivatives party determination (and manage its relationships accordingly) at the product type level, or it is only practicable for a derivatives dealer or adviser to treat a derivatives party as an eligible derivatives party (or not) for all purposes?

ISDA submits that it would be very difficult, if not impossible, for dealers and advisers to obtain, implement and manage EDP status determinations on a product level. While derivative firms may choose to limit the types of products they transact with certain derivative parties (for suitability or other reasons), we do not think that process should be managed by making EDP status a product-level determination. Given the broad range of products traded in the derivatives market, it would be very difficult to come up with product categories that could work on a market wide basis. From a pure implementation standpoint, such an approach would be extremely challenging to integrate into current processes and existing trading and operations workflows and we are not aware of similar product level differentiation in the context of derivatives business conduct rules in other jurisdictions. We respectfully submit that this approach would introduce enormous complexity without any benefit.

4. Two-tiered approach to requirements: eligible derivatives parties vs. all derivatives parties

Do you agree with the two-tiered approach to investor/customer protection in the Instrument?

While ISDA generally supports the two-tiered approach, we do not think it goes far enough in addressing the institutional market in derivatives. We suggest the CSA introduce a third tier for transactions between dealers (both foreign and domestic) which would be exempt from all requirements in the Proposed Rule (effectively an outright exemption for the inter-dealer market). Such an approach, for example, would allow foreign dealers to transact with Canadian dealers (including Canadian banks) without having to address the Proposed Rule. Absent such a “third tier”, foreign dealers that only participate in the inter-dealer market may be reluctant to continue to transact with Canadian dealers due to the increased compliance burden. This could result in less liquidity being available in the Canadian markets. We submit that even the limited requirements applicable to EDPs under the Proposed Rule are not necessary in the context of inter-dealer activity and that therefore this third tier is appropriate.

Are there additional requirements that a derivatives firm should be subject to even when dealing with or advising an eligible derivatives party? For example, should best execution or tied selling obligations, or other obligations in Division 2 of Part 3, also apply when a derivatives firm is dealing with or advising an eligible derivatives party?

ISDA does not believe that any additional requirements should be applicable to EDPs beyond those contemplated under the Proposed Rule.

Does the Proposed Instrument adequately account for current institutional OTC trading practices? Are there requirements that apply to a derivatives firm in respect of an eligible derivatives party that should not apply, or that impose unreasonable burdens that would unnecessarily discourage trading in OTC derivatives in Canada?

As explained in other portions of this letter, ISDA believes a number of the requirements in the Proposed Rule are unnecessary given the nature of the OTC derivatives market in Canada. We are concerned that the Proposed Rule will reduce liquidity and the availability of advisory services in relation to OTC derivatives (particularly in the cross-border context).

In particular, ISDA believes that many of the requirements imposed on both dealers and advisers should not be applicable to advisers. Where an adviser transacts in derivatives on behalf of its investor client, the transaction which is executed is between the investor and the dealer. Therefore, requirements in the Proposed Rule such as the obligation to make disclosures regarding the use of borrowed money or leverage and the daily reporting requirements should only apply to derivatives dealers and should not be imposed on derivatives advisers (which are not a party to the transaction). Similarly, many of the specific obligations imposed on advisers in the Proposed Rule such as fair dealing, conflicts of interest and suitability are covered by an adviser’s fiduciary duties to its client and we do not believe the Proposed Rule should impose duplicative requirements in the context of derivatives.

Should the two tiered approach apply to a derivatives adviser that is advising an eligible derivatives party?

ISDA believes that derivatives advisers should be able to look through to the EDP status of their underlying clients in order to determine which requirements in the Proposed Rule must be applied. We believe that this approach should be followed even when a client has invested through an adviser’s managed account platform. We would ask the CSA to reconsider the provision in Section 7(3) of the Proposed Rule which would apply the full set of requirements of the Proposed

Rule to a derivatives adviser in respect of a managed account of an EDP. In our opinion, the underlying EDP does not need the full set of protections even where they have made a determination that it is appropriate to retain an adviser for expertise that they may not have.

The CSA Notice and Request for Comment indicates that the term "eligible derivatives party" refers to those derivatives parties that "do not require the full set of protections afforded to "retail" customers or investors, either because they may reasonably be considered sophisticated or because they have sufficient financial resources to purchase professional advice or otherwise protect themselves through contractual negotiation with the derivatives firm". We submit that this description covers an EDP investor who has hired a derivatives adviser to manage its assets through a managed account structure. The managed account structure will be subject to the terms of an investment management agreement ("IMA") that has been contractually negotiated between two sophisticated parties. In addition to the contractual obligations set out in the IMA, the adviser will be required to meet its fiduciary obligations to the EDP investor. An EDP that has the benefit of both an adviser and an IMA should need fewer protections under the Proposed Rule than an EDP that transacts with a dealer directly without an adviser.

If, notwithstanding the points made above, the CSA are of the view that the EDP requires additional protections that go beyond what would apply to an adviser to an EDP under the Proposed Rule when a managed account structure is not used, then ISDA submits it should be sufficient to only apply the requirements of Section 11 (Derivatives Party Specific Needs and Objectives) and Section 12 (Suitability). If the CSA are not willing to amend or preferably remove section 7(3) in its entirety in the final rule, we submit at a minimum that an EDP should be able to agree in writing with its adviser to be treated as if it was not in a managed account arrangement (i.e., to waive those provisions that would otherwise apply as a result of the application of section 7(3)).

The costs associated with full compliance with section 7(3) will be significant, and this could result in a reduction in managed account services offered to EDPs. For this reason, we would ask the CSA to reconsider the treatment of managed accounts under the Proposed Rule.

5. Business trigger guidance

Part 1 of the CP sets out factors that are considered relevant in determining whether a person or company is in the business of trading or advising in derivatives. One of those factors is as follows:

***Quoting prices or acting as a market maker* – The person or company makes a two-way market in a derivative or routinely quotes prices at which they would be willing to transact in a derivative or offers to make a market in a derivative or derivatives.**

Similarly, paragraph 39(c) of the Instrument provides that the exemption described therein is only available if "the person or company does not regularly quote prices at which they would be willing to transact in a derivative or otherwise make or offer to make a market in a derivative with a derivatives party".

Does the guidance in the CP, along with 39(c) of the Instrument, appropriately describe the situation in which a person or company should be considered to be a derivatives dealer because they are functioning in the role of a market maker?

ISDA believes that the guidance in the CP, along with paragraph 39(c) of the Proposed Rule, adequately describes the role of a market maker. However, there are several other aspects of the derivatives dealer definition on which we would like to comment.

As a general matter, we think the proposed definitions of derivatives dealer and derivatives adviser do not offer the level of precision and clarity that would enable derivatives parties to receive definitive legal advice on whether their activities bring them into the scope of these definitions. Given the significance of qualifying as a derivatives dealer or derivatives adviser under the Proposed Rule, market participants need to be able to determine whether they are in scope or not.

Relevant Factors

In our view, the definition of a "derivatives dealer" should be modified to include market making as the only factor that would determine whether an entity is acting as a derivatives dealer. However, if the CSA are not willing to limit the scope of derivatives dealing to market making, in the alternative, we request that the factors in section 1 of the CP be narrowed and clarified. For example, factors such as "engaging in activities similar to a derivatives adviser or derivatives dealer" are very hard to apply in practice and will make it impossible for many entities to definitively determine if they are in scope or not. We submit this is problematic notwithstanding the end-user exemptions contemplated in paragraph 39 of the Proposed Rule. Rather than putting too much reliance on the end-user exemptions, we believe the definitions of derivatives dealer and derivatives adviser should be drafted with greater precision to only capture the entities that are truly engaged in dealing and advising activities.

To that end, we request that the CSA clarify that, absent other factors, the mere act of engaging in frequent or regular trading would not result in an entity qualifying as a derivatives dealer. Similarly, we believe that facilitating or intermediating transactions as a broker - absent other business trigger factors – should not result in an entity being a derivatives dealer. We suggest that references in the Proposed Rule to "business of trading in derivatives" be changed to "business of dealing in derivatives" to better distinguish between dealing and trading activity. We strongly believe that a *de minimis* threshold should be included to avoid entities, whether foreign or Canadian, with limited trading activity with Canadian clients being brought in scope for derivatives dealer status. This approach would be consistent with the notion of the *de minimis* threshold under CFTC rules pursuant to which persons with USD $8 billion in aggregate gross notional amount of swaps (measured over a 12-month period) are automatically excluded from the definition of a "swap dealer".

Jurisdictional Scope

ISDA believes that the requirements in the Proposed Rule should only apply to dealing or advising activity conducted with Canadian counterparties located in Canada. Certain provisions in the CP suggest that the Proposed Rule might extend to activities conducted in a foreign jurisdiction. We request that the CSA clarify the jurisdictional scope in the final rule.

Agency

The definition of "derivatives dealer" includes companies or persons trading in derivatives as agent. We request that the CSA clarify what agency roles are intended to be captured by this part of the definition given that transactions in the OTC derivatives market are generally entered into on a principal basis. The same question arises in paragraph (a)(i) of the definition of "derivatives party" which refers to a derivatives dealer acting or proposing to act as agent in relation to a derivative.

Clearing Services

One of the factors for determining derivatives dealer status is "providing derivatives clearing services". Other than acting as a dealer facing a counterparty in a cleared derivative, we request that the CSA clarify what other clearing services are contemplated. For example, we would ask the CSA to confirm that a firm which acts as a clearing broker would not be considered to be a derivatives dealer solely as a result of acting as a clearing broker.

Exemptions

While ISDA believes that the end-user exemption in section 39 of the Proposed Rule is helpful (particularly given the wide definition of derivatives dealer), we suggest that the CSA supplement the current version of section 39 with specific exemptions for categories of end-users. For example, it would be helpful to have a specific exemption from the derivatives dealer definition for insurance companies, pension funds and investment funds to avoid any ambiguity as to whether they could be in scope as dealers for purposes of the Proposed Rule.

ISDA is of the view that the availability of the end user exemption in section 39 should not be restricted to parties that interact solely with EDPs. A derivatives party's status as an end-user should depend on the activities undertaken by such party in the ordinary course of business as opposed to the type of counterparty with whom that end-user engages. As such, we request that the CSA amend sections 39(a) and 39(b) accordingly. ISDA also believes that the end user exemption should be further amended by removing the words "regularly facilitate" in section 39(d) and deleting section 39(e). We submit that phrases such as "regularly facilitate" and "facilitate" are too ambiguous and would prevent firms, which would otherwise qualify for the exemption in Section 39, from obtaining definitive legal advice as to their end-user status.

6. Fair Dealing

Is the proposed application of a flexible fair dealing model that is dependent on the relationship between the derivatives firm and its derivatives party appropriate?

While ISDA generally supports the fair dealing model contemplated in section 8 of the Proposed Rule, we submit that the requirement should be to "communicate fairly, honestly and in good faith". An emphasis on communication would better reflect the nature of derivatives relationships (which involve ongoing, bilateral obligations during the course of a transaction) and also align the Proposed Rule with the fair dealing obligations imposed on registered swap dealers under the CFTC rules.

We also believe that the specific requirement in Section 8(3) around allocation of transaction opportunities by derivative advisers is not necessary given the much broader fiduciary standard which derivatives advisers are subject to. ISDA believes that the CSA should take greater account of the fiduciary standard imposed on derivative advisers and avoid imposing duplicative requirements that are already covered by the broader fiduciary framework governing the activities of advisers.

7. Fair terms and pricing

Are the proposed requirements in section 19 of the Instrument relating to fair terms and pricing appropriate?

Section 19(1) of the Proposed Rule provides that a derivatives firm that acts as agent for a derivatives party must establish policies and procedures that are reasonably designed to obtain the most advantageous terms reasonably available. In the case of advisers, we submit that these requirements are part of the overall duty imposed on a fiduciary and that is it not appropriate to impose specific requirements regarding pricing terms in the context of derivatives.

We also submit that this standard is not appropriate for dealers given that a significant percentage of derivatives transactions are entered into over the counter on a bilateral basis. As noted above, we ask the CSA to reconsider the inclusion of an agency role for derivatives dealers given that OTC derivatives are executed on a principal basis.

Section 19(2) of the Proposed Rule requires derivatives dealers to make a reasonable effort to provide a price for the derivative party this is "fair and reasonable taking into consideration all relevant factors". The CP says that a derivatives firm must take into account both the market value of the derivatives and the reasonableness of compensation in making this determination. ISDA is of the view that this standard is too open ended for derivatives dealers to implement. Prices are a matter of negotiation between the parties and are determined by many factors, including the risk, liquidity and collateral terms associated with the transaction. Users of derivatives are able to compare prices and terms by soliciting quotations from multiple dealers. Imposing a regulatory obligation that prices must be fair and reasonable creates ambiguity and heightened legal uncertainty for dealers and advisers without any clear justification or benefit for derivatives end users. The increased risks associated with this legal uncertainty could discourage dealers and advisers from providing liquidity and advisory expertise to certain segments of the market.

8. Derivatives Party Assets

National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* imposes obligations on clearing intermediaries that hold collateral on behalf of customers relating to derivatives cleared through a clearing agency that is a central counterparty. These requirements apply regardless of the sophistication of the customer. Division 2 of Part 4 of the Instrument imposes comparable obligations but does not apply if the derivatives party is not an eligible derivatives party. Should Division 2 of Part 4 apply if the derivatives party is an eligible derivatives party?

ISDA does not believe that derivative party assets (including assets posted as margin) should be regulated as part of business conduct requirements. Unlike in the securities context, derivatives dealers do not carry client assets (other than assets posted or transferred to the dealer to satisfy margin requirements). As a result, ISDA does not see a need for the Proposed Rule to address how derivative party assets are held, used or invested. Such requirements are best addressed (as applicable) in other rules such as the uncleared margin rules modelled on the BCBS-IOSCO margin framework for uncleared derivatives. We would ask the CSA to amend the Proposed Rule to remove the restrictions on the use and investment of posted collateral so as to allow derivatives parties to continue using and investing collateral in accordance with the terms of their collateral documentation (subject to any other regulatory requirements such as the margin requirements for uncleared derivatives). We note that the current provisions would have detrimental pricing and liquidity implications for market participants as non-cleared derivatives are currently priced on the assumption that posted collateral can be used or invested in accordance with standard market practice, as reflected in the terms agreed to in the collateral documentation. In addition, ISDA would ask the CSA to clarify that the exemption from Division 2 contained in section 24 of the Proposed Rule is available where parties are relying on the substituted compliance provisions in National Instrument 94-102.

9. Valuations for derivatives

Section 21, 22 and 30 require a derivatives firm to provide valuations for derivatives to their derivatives party. Should these valuations be accompanied by information on the inputs and assumptions that were used to create the valuation?

ISDA does not think derivatives firms should be required to provide this information. As explained elsewhere in this letter, we do not think derivatives firms should be required to provide valuations (or any related inputs and assumptions). Instead, the obligation should be limited to providing a mid level mark consistent with the approach followed by swap dealers under CFTC rules.

If it is necessary for an adviser to provide valuation information to its clients, we would submit that daily valuation reporting is both onerous and unnecessary. It should be sufficient for an adviser to provide such reporting on a monthly basis unless otherwise agreed in writing. That approach would be consistent with the current practice in the securities markets.

10. Senior derivatives managers

Please comment on the proposed senior management requirements including whether the proposed obligations are practical to comply with, and the extent to which they do or do not reflect existing best practices.

While we agree that senior derivatives managers should be responsible for supervising, promoting compliance and addressing non-compliance within their business units, we believe the imposition of a specific responsibility to prevent non-compliance as provided in the Proposed Rule is not appropriate. Where such a duty has been introduced for senior managers in other jurisdictions (such as the UK senior manager's regime), it has been part of a comprehensive framework across business lines that includes responsibility mapping, employee certification and allocation of prescribed responsibilities at the enterprise level. The Proposed Rule would charge a senior derivatives manager with taking reasonable steps to prevent non-compliance "with respect to the derivatives activities conducted in his or her derivatives business unit". We submit that such broad-based responsibility is never assigned to a single individual but is a shared responsibility across multiple functions, including compliance, risk and the board. For that reason, we submit that this specific requirement in Section 33(1)(c) of the Proposed Rule should be reconsidered.

The Proposed Rule says a senior derivatives manager would be "in breach in terms of identifying and reporting non-compliance even if the senior manager has delegated responsibilities and has not been properly advised of the non-compliance". With respect to delegation, we submit that the responsibility of the senior derivatives manager should be to ensure that any delegation is to an appropriate person and that they oversee the delegation effectively. There should be no automatic breach for failure due to the action or inaction of someone to whom responsibilities have been properly delegated.

The reporting obligation in section 33(2) contemplates reporting to the board of directors (or individuals acting in a similar capacity for the derivatives firm). ISDA submits that reporting at this level of a derivatives firm (i.e., the board or equivalent body) may not be appropriate in all cases. There should be flexibility to submit the reports contemplated in section 33(2) to senior management in lieu of reporting to the board (or its equivalent). For example, in the case of a large firm with a relatively small derivatives business unit, it would be appropriate for the reports under section 33(2) to be made to senior management (with reporting to the board (or the applicable equivalent body) where the contents of the report merit escalation). We also submit that the reporting obligation should be the responsibility of the chief compliance officer ("CCO") of the derivatives firm or, alternatively, the CCO or the senior derivatives manager (as determined by the derivatives firm).

The CP states that the senior derivatives manager must exercise reasonable care in determining when and how often material non-compliance should be reported to the board of directors. For example, in the case of "serious misconduct", the CP says the board should be made aware of the matter "promptly" and that it should be reported to securities regulators in a "timely manner". ISDA suggests that the language in the second bullet of section 34 of the CP be amended to add the words "after review by the board" following the words "timely manner" in order to make it explicit that derivatives firms will have an opportunity to raise the issue with their board before being required to report to the regulators.

ISDA asks the CSA to confirm that the list of examples of material non-compliance set out in the CP is meant to reflect what the CSA mean by "serious misconduct". It is our view that the example that currently reads: "has, or could have, a negative impact on the interest of a derivative party," is too far reaching. We request that this example be removed or revised to incorporate a materiality component.

We agree that it is appropriate to report matters that constitute "serious misconduct" to the board and regulators more frequently than annually. However, we would submit that it should be sufficient to report to the regulators all other instances of material non-compliance "no less frequently than on an annual basis" and following the review of the annual report by the board as contemplated in Section 33(2).

Annual certification that the business unit is in material compliance with the Proposed Rule, applicable securities legislation and policies and procedures of the derivatives seems disproportionate and unnecessary given the proposed responsibility to report instances of non-compliance. We submit that the annual certification requirements should be excluded in the final rule.

We would also ask the CSA to consider the possible implications of imposing the senior derivatives manager regime in the context of cross-border activities. If derivatives firms that are not subject to such a regime in their home jurisdiction are required under the Proposed Rule to implement this framework just for Canadian local clients, this requirement could act as a disincentive to continuing to provide services to Canadian clients. While ISDA supports a robust customer protection regime for Canadian derivatives clients, we caution against imposing requirements that are so out of step with other major jurisdictions that they could result in less cross-border liquidity and advisory expertise being made available for Canadian clients.

11. Exemptions

Sections 40, 41, 42, and 44 of the Instrument contemplate exemptions for derivatives firms, conditional on being subject to and complying with equivalent domestic or foreign regulations. Please provide information on regulations that the CSA should consider for the equivalency analysis. Where possible, please provide specific references and information on relevant requirements and why they are equivalent, on an outcomes basis, to the requirements in the Instrument.

While ISDA supports the provisions in the Proposed Rule which would allow substitute compliance, the potential benefits will only be known once the CSA indicate which corresponding domestic and foreign laws can be complied with in lieu of the Proposed Rule and the residual provisions of the Proposed Rule which will still need to be followed in each case. We request that the CSA publish those corresponding laws and applicable residual provisions for consultation in advance of finalizing the Proposed Rule so that market participants can provide feedback. While ISDA was not directly involved in the work done by the Canadian Market Infrastructure Committee ("CMIC") in identifying comparable domestic and foreign laws that should qualify for substitute compliance under the Proposed Rule, we would refer the CSA to the results of CMIC's analysis which is included in CMIC's comment letter to the CSA on the Proposed Rule.

In order to rely on the exemptions in Section 40 and Section 44, foreign dealers and foreign advisers must provide a disclosure statement to the derivative party (pursuant to Section 40(3)(c) in the case of foreign dealers and Section 44(3)(c) in the case of foreign advisers. A similar statement must be delivered by all non-resident derivatives firms pursuant to Section 23 but only to derivative parties that are not EDPs. Given that foreign dealers and foreign advisers can only rely on the exemptions in Section 40 and Section 44 if they limit their activities to EDPs, it seems inconsistent to require them to deliver a statement if Section 23 only requires the statement to be delivered to non-EDPs. We submit that EDPs do not require this information and that the conditions in Section 40(3)(c) and Section 44(3)(c) of the Proposed Rule should be deleted.

The exemption for foreign dealers and adviser based on substituted compliance is not available if the dealer or adviser is in the business of trading in derivatives on an exchange or a derivatives trading facility designated or recognized in a Canadian jurisdiction. We submit that this restriction should not be necessary and ask the CSA to clarify why trading on such an exchange or DTF should make the dealer/adviser ineligible for substitute compliance provided they only deal with EDPs.

PART II - ADDITIONAL COMMENTS

In addition to the responses to the specific questions raised by the CSA, ISDA has other comments on the Proposed Rule which are set out below.

1. Effective date and scope of proposed rule

We submit that the requirements in the Proposed Rule should only come into effect after the proposed registration regime for derivatives firms is in place to allow sufficient time to implement appropriate policies and procedures, train relevant personnel, receive any required representations, execute any required amendments to counterparty documentation and put in place any new required counterparty documentation. Also, to the extent the CFTC proposes amendments to its business conduct standards as part of its recently launched KISS review, we would ask the CSA to delay finalizing its business conduct proposals until any amendments to the CFTC business conduct proposals are finalized. It is important in our view that Canada remain harmonized as much as possible with large markets for derivatives like the United States.

We request that the CSA clarify that the requirements in the Proposed Rule will not apply to unexpired derivatives that were entered into before the effective date of the Proposed Rule other than ongoing requirements (i.e., fair dealing (Section 8), daily reporting (Section 22) and derivatives party statements (Section 30)).

Section 46(1) of the Proposed Rule contemplates grandfathering of derivatives that are entered into before the effective date of the Proposed Rule and which expire or terminate not later than 365 days after that date. We submit that, other than the ongoing obligations identified above, all pre-effective date transactions (regardless of their remaining term) should be grandfathered. That grandfathering should apply even if pre-effective date transactions are subsequently amended after the date of any final rule.

ISDA supports the exclusion of governments, central banks and international organizations (collectively, “Section 6 Excluded Entities”) from the requirements of the Proposed Rule. We are unclear if Section 6 is saying that Section 6 Excluded Entities are not derivatives dealers and derivatives advisers or if the intention is that the requirements of the Proposed Rule should not apply whenever at least one party is a Section 6 Excluded Entity. ISDA believes the Proposed Rule should not apply if either party to a transaction is a Section 6 Excluded Entity and we would ask the CSA to clarify Section 6 accordingly in the final rule. ISDA also submits that the list of Section 6 Excluded Entities should include “crown corporations, government agencies and any other entity which is wholly owned or controlled by, or all or substantially all of whose liabilities are guaranteed by, one or more governments or other such entities”. We also submit that the reference to “government of a foreign jurisdiction” in Section 6(a) should be expanded to explicitly include state, regional and local governments in foreign jurisdictions.

2. Conflict of interest

ISDA suggests that the CSA consider amending the requirements in section 9 of the Proposed Rule related to disclosure of conflicts of interest as follows:

(a) Given that advisers are subject to broad fiduciary obligations, we do not believe it is necessary or appropriate to impose specific conflict of interest requirements in the context of their derivatives advisory activities. The elements of the conflict of interest rule applicable to derivatives advisers – including the requirements under the heading “Competing interests of derivatives parties” – are covered as part of the fiduciary standard. For this reason, ISDA suggests that the obligations in section 9 of the Proposed Rule should only apply to derivatives dealers.

(b) Consistent with industry practice, standardized disclosures should be permitted provided additional or particularized disclosures are made available in connection with specific transactions as appropriate. It should be sufficient if standardized disclosures are provided reasonably sufficiently prior to a transaction is entered into (including through website disclosure).

(c) The CP lists “acting as both dealer and counterparty” as an example of a conflict of interest that must be disclosed. We submit that market participants generally understand that the interests of two parties to a derivative are divergent (i.e., they are on opposite sides of a transaction). It is not customary to disclose this fact as part of conflicts of interest disclosure and we recommend that it be deleted from the Proposed Rule.

(d) The CP lists "competing interests of derivatives parties" as an example of a potential conflict of interest, and says that the CSA expect a derivative firm to make reasonable efforts to be "fair to all such derivative parties". This requirement is quite vague and it is unclear what obligations the CSA is seeking to impose in this context. We request that the CSA further explain what this requirement is seeking to address or otherwise consider deleting it from the Proposed Rule.

(e) The CP lists "compensation practices" as an example of a potential conflict of interest, and suggests that there may be circumstances where compensation may be a reason not to offer a product to a derivative party. We submit that a derivative firm's obligation in this context should be to make the required disclosures. While a derivative firm may decide not to offer a derivative to a particular counterparty, we submit that the amount of compensation associated with a transaction is generally not – in and of itself – a conflict of interest.

(f) The Proposed Rule lists avoidance as one of the reasonable methods of response to a conflict of interest. However, beyond cases where the conflict of interest is prohibited by law, it is unclear when a market participant would be expected to avoid a conflict. The CSA states in the CP that "where conflicts of interest are so contrary to another person's interest that a derivatives party cannot use controls or disclosure to reasonably respond to them, we expect that the derivatives firm to avoid the conflict, stop providing the service or stop dealing with the derivatives party". This standard is vague. In the context of an arm's length trading relationship, it would be difficult if not impossible in many cases for a derivatives dealer to know or determine what the other party's interests may be. Confronted with such a vague standard, derivatives firms will struggle to determine if withdrawal of services is required or if its regulatory obligations can be met through control and disclosure. For conflicts of interests that are not prohibited by law, we submit that the only regulatory requirement should be to identify and disclose material conflicts.

(g) Under the subheading "Controlling conflicts of interest", the CP refers to "advisory staff reporting to marketing staff" as an example of a situation that would likely raise a potential conflict of interest. ISDA assumes this reference is meant to capture the divide between public side and private side employees and the need to ensure that reporting lines respect public/private side information barriers. If this is the case, we request that the CSA clarify this point in the Proposed Rule.

(h) We submit that an exemption from the conflicts of interest requirement is necessary where the derivatives dealer does not know the identity of its counterparty prior to execution and therefore cannot identify and address conflicts of interest as contemplated in the Proposed Rule. This would be the case, for example, where transactions are initiated on a swap execution facility ("**SEF**").

3. General know your derivative party requirements

Section 10(2)(c) of the Proposed Rule would require derivatives dealers and derivatives advisers, in connection with securities based derivatives, to establish if their counterparty (i) is an insider of a reporting issuer or any other issuer whose securities are publicly traded or (ii) would be reasonably expected to have access to material non-public information (MNPI) relating to any interest underlying the derivative. We suggest that the CSA reconsider these requirements. ISDA is not aware of an analogous requirement under similar KYC rules for derivatives in other jurisdictions. While it may make sense to require this information in the context of securities trading, we do not see why this information should be required for derivatives. Given that derivatives (including index based products) can reference many different underling issuers, it would not be practicable for derivatives firms to collect this information and keep it current. It is also unclear if this information regarding possession of MNPI would need to be assessed each time a derivative referencing an underlying issuer is entered into. To the extent the CSA are concerned about parties transacting in security-based derivatives while in possession of MNPI, we suggest that this should be addressed in another manner (and not by making derivatives firms collect the information as part of KYC requirements).

Section 10(4) of the Proposed Rule requires derivative firms to take reasonable steps to ensure that KYC information required under Section 10 is kept current. ISDA submits that the onus should be reversed and that the information collected under section 10 should be deemed to be current unless a client informs a derivatives firm otherwise.

ISDA also requests that the exception in Section 10(5) be expanded to cover all EDPs or, if that is not deemed appropriate, at least to cover all EDPs that are regulated entities.

4. Suitability

Section 12 of the Proposed Rule provides that <u>both</u> derivative dealers and derivative advisers must take reasonable steps to ensure that, before they make a recommendation to or accept an instruction from a derivative party to transact in a derivative, the transaction is suitable for the derivative party. In the context of derivatives advisers, we believe that such obligations are already covered by the adviser's broader fiduciary obligations and we do not think a specific suitability obligation specifically for derivatives is necessary or appropriate.

In the case of derivative dealers, the suitability obligation in Section 12 should only be triggered when the derivative dealer has made a recommendation; suitability obligations should not apply simply as a result of an "instruction … to transact". The Proposed Rule does not contain a definition of "recommendation"; we request that the CSA issue further guidance regarding the factors to be considered when determining whether a communication constitutes a "recommendation". We submit that a communication should only constitute a recommendation where is tailored to a particular client (or category of clients) and can reasonably be viewed as a "call to action".

Given that dealers transact with their counterparties as principals (and not as advisers), it is important that the CSA include a safe harbour from the suitability requirements in the Proposed Rule for circumstances where the derivatives dealer obtains appropriate representations from the counterparty (or, where applicable, its agent) and discloses to the counterparty that it is not assessing suitability. A waiver option similar to that provided in Section 13.2(6) of National Instrument 31-103 should also be included in the Proposed Rule. It is also important that the Proposed Rule be amended to include a carve-out from suitability for transactions executed on a venue (like a SEF) where the derivatives dealer is not able to assess suitability due to the anonymous nature of the trade execution. A carve-out from suitability obligations should also be available for dealers where they execute block trades with an adviser acting on behalf of multiple underlying accounts; the dealer may not know at the time of execution which of the adviser's accounts will be allocated the trade and therefore it will not be possible to assess suitability in advance of trading.

Relief from suitability requirements should also be available for derivatives that are intended to be cleared ("ITBC Transactions") for the same reasons outlined by the CFTC in CFTC No Action Letter 13-70 (a copy of which can be found at http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/13-70.pdf). We think the same reasons why the CFTC granted relief in this context are applicable in the Canadian market.

Similar safe harbors and carve-outs to those discussed above should be added to the Proposed Rule for the KYC requirements in Section 11.

5. Referral arrangements

Sections 13 to 15 of the Proposed Rule would impose documentation, recordkeeping and disclosure obligations whenever a derivative firm enters into an arrangement to pay or receive any form of compensation, direct or indirect, for the referral of a derivative party to or from the derivative firm.

ISDA believes that these referral arrangements are too broad. While CFTC rules prohibit swap dealers from making certain referrals to counterparties that qualify as "special entities", they do not impose requirements on referral arrangement similar to those contemplated under the Proposed Rule. At a minimum, we would argue that requirements should only apply to referral arrangements that specifically involve derivatives.

6. Disclosure regarding the use of borrowed money or leverage

Section 16 of the Proposed Rule would require derivatives firms to provide a written disclosure statement regarding the use of borrowed money or leverage to a derivatives party prior to entering into a transaction. To avoid duplicative disclosure to clients, ISDA believes this obligation should only apply to derivatives dealers. We also request that the CSA confirm that posting of the disclosure on a derivative firm's website in a readily accessible location will be sufficient for purposes of ensuring the relevant disclosure has been provided (and refreshed as required).

7. Derivatives Party Accounts - Disclosure to Derivative Parties

We submit the some of the relationship documentation listed in Section 20(2), which may be relevant in the context of a securities account, is not applicable for a derivatives relationship. For example, the requirement to describe the risk of using borrowed money to finance a derivative seems unnecessary given that market participants do not generally use borrowed money to finance derivatives in the same way parties regularly purchase securities on margin. Similarly, we do not see how the disclosure requirement with respect to performance benchmarks (section 20(2)(m)) is applicable in the context of derivatives.

In addition, we note that Section 14.2(3) of NI 31-103 permits oral disclosure of the information referred to in Section 20(2)(b) of the Proposed Rule in addition to written disclosure in the context of the securities markets. We request that Section 20(2) be revised to incorporate this same approach for the derivatives markets as we are of the view that a different approach is not necessary or justified when the information is simply a general description of the products and services that the derivatives firm offers.

8. Derivatives Party Accounts - Pre-transaction Disclosure

We submit that the requirement in Section 21(1)(a) for derivatives dealers to provide a derivative party with "an analysis of the derivative party's potential exposure under the type of derivative" should only apply where the analysis is requested by the counterparty. This would align the Proposed Rule with requirements under the CFTC rule to provide scenario analysis upon request.

We request that the CSA confirm that standardized disclosures of materials risks and material characteristics are acceptable where appropriate. We also request confirmation that such disclosures can be made by directing a derivatives party to the appropriate page on a derivative firm's website where the disclosures are available.

We would ask the CSA to confirm that pre-transaction disclosures of all kinds do not apply where a derivative transaction is an ITBC Derivative and/or is initiated on a venue (e.g., a SEF). Whether a SEF transaction is executed anonymously or not, it is the SEF that onboards the counterparty (not the dealer) and therefore there should be no onus placed on the dealer to promote properly functioning SEF trading.

Section 21(2)(b) provides that a derivatives dealer must disclose "if applicable, the price of the derivative to be transacted and the most recent valuation". We have the following comments on this sub-clause:

(a) We would ask the CSA to clarify the inclusion of the phrase "if applicable" (i.e., when would it not be applicable to disclosure these items).

(b) To avoid any suggestion that derivatives firms are providing valuation services, we would ask the CSA to amend the reference to "recent valuation" to "mid-market mark". Consistent with the CFTC rules, we submit the mid-market mark should not include amounts for profit, credit reserve, hedging, funding, liquidity or other costs or adjustments.

(c) If price and mid-market mark are disclosed, we request that the CSA reconsider requiring derivatives firms to provide additional disclosure "with respect to spreads, premiums, costs, etc." as contemplated in the CP.

Section 21(2)(c) requires disclosure of "any compensation or other incentive payable by the derivative party related to the derivative or the transaction in the derivative". We would ask the CSA to clarify what additional information this is intended to capture (other than the disclosure under 21(2)(b)).

9. Daily Reporting

We submit that the requirement in Section 22 of the Proposed Rule to make available a daily "valuation" with respect to a derivative should instead be a requirement to make available a "mid-market mark". We also request that the CSA clarify that this requirement only applies to uncleared derivatives; in the case of cleared derivatives, it should be sufficient for the derivatives firm to notify the derivatives party of its right to request and receive the clearing agency's daily mark. We also request that this obligation only apply to derivatives dealers and not to derivatives advisers given that advisers are not parties to the transactions being executed. As indicated above, daily valuation reporting is both onerous and unnecessary. It should be sufficient for an adviser to provide such reporting on a monthly basis, unless otherwise contractually agreed, which is consistent with the current practice in the securities markets.

10. Derivatives Party Statements

Sections 30(2)(d) and 30(2)(f) of the Proposed Rule refer to derivatives party assets "held by" the derivatives firm. We would ask the CSA to clarify when derivatives party assets, whether collateral or otherwise, are considered to be "held by" a derivatives firm, with specific examples that may apply to a derivatives dealer and a derivatives adviser.

11. Reporting to derivatives parties: Transaction Confirmations

While we agree and support the requirement that transactions be confirmed in writing as contemplated in paragraph 29(1) of the Proposed Rule, we submit that the prescriptive requirements as to the contents of those confirmations are not appropriate and are inconsistent with the rules in other jurisdictions related to trade confirmations for derivatives. We request that the CSA clarify that this requirement only applies to uncleared derivatives. We also would ask the CSA to confirm that electronic confirmations (including SWIFT confirmations) satisfy the "in writing" requirement.

12. Recordkeeping

For transactions that are initiated on a SEF, ISDA requests that the CSA provide an exemption from the requirement in section 35 to enter into a derivatives agreement with a derivatives party before transacting.

We also note that the requirement in section 35(1) to have an agreement in place with a counterparty before entering into a transaction is not practicable in the context of foreign exchange trading where firms regularly enter into transactions prior to completing an ISDA Master Agreement. We request that the CSA include a carve-out from this requirement for foreign exchange transactions as well as all cleared derivatives.

With respect to recordkeeping, ISDA believes the CSA should implement a single (and shorter) record retention period of five years from the date of termination of the derivative.

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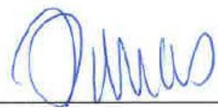
ISDA and its member would like to reiterate our appreciation to the CSA for the opportunity to provide feedback on the Proposed Rule. We are happy to discuss our responses and to provide any additional information that may be helpful.

Thank you for your consideration of these important issues to market participants. Please contact the undersigned if you have any questions or concerns.

Sincerely,



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