

June 13, 2022

Submitted via email to memberpolicymailbox@iiroc.ca and marketregulation@osc.gov.on.ca

Member Regulation Policy
Investment Industry Regulatory Organization of Canada
121 King St West
Suite 2000
Toronto ON
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Market Regulation
Ontario Securities Commission
Suite 1903
20 Queen Street West
Toronto ON
M5H 3S8

Re: Re-publication of Proposed Derivatives Rules Modernization, Stage 1 (“Proposed Amendments”)

Dear Sirs and Mesdames:

The Investment Industry Association of Canada (the “IIAC”) appreciates the opportunity to provide comment on the Investment Industry Regulatory Organization of Canada (IIROC) Proposed Amendments. The IIAC submitted detailed comments during IIROC’s first round of industry consultations in 2020¹. We are pleased to see that many of our initial comments and recommendations were reflected in the Proposed Amendments. However, there continues to be some areas where further clarification or amendment is required. We again emphasize that Over-the-Counter (“OTC”) derivatives require special considerations and extending certain of the Proposed Amendments to this category of derivatives poses compliance challenges for our members and risks proper market functioning. The Proposed Amendments need to be harmonized with the equivalent CSA requirements, namely Proposed NI 93-101 Derivatives: Business Conduct and NI 93-102: Registration. Furthermore, dealer member compliance with the CSA’s derivatives business conduct rules should be recognized by IIROC in its determination of member adherence to comparable IIROC rules.

The IIAC is the leading association representing investment firms in the Canadian securities industry.

¹ See IIAC [comment letter](#) dated February 19, 2020.

Summary:

Several of the IIAC's 2020 concerns have been addressed in the Proposed Amendments. However, further changes to IIROC's proposed Derivatives Rules are required to appropriately reflect the different classes of derivatives captured. Given the scope of the Proposed Amendments and the imposition of new requirements impacting processes, procedures, documentation and systems of the Dealer, an extended rule implementation period will be required by industry.

Key Recommendations:

1. To protect against regulatory arbitrage the Proposed Amendments should be harmonized with regulations being developed by other securities regulators, notably CSA National Instruments 93-101 and 93-102. Dealer member adherence to NI 93-101 should be recognized by IIROC in its determination of member adherence to comparable IIROC rules.
- 2 The IIAC proposes further amendments to the following key defined terms: "Derivative", "Institutional Client" and "Hedger".
3. For OTC derivatives, "fair price" obligations should be interpreted to mean what is commercially reasonable.
4. IIROC should publish a guidance note pertaining to the Enhanced Risk Disclosure Agreement.
5. IIROC should adopt a more flexible approach for dealers to meet their delivery requirements for daily client account statements.
6. IIROC Staff should acknowledge and accept the reasonable exercise of a member's professional judgement in determining whether a significant business disruption or impairment has occurred and, if so, the steps the firm should take in response.

1. Defined Terms in the Proposed Amendments

In our 2020 response the IIAC requested that, where possible and appropriate, IIROC harmonize its derivatives regulations with that of other domestic regulators. This would guard against regulatory arbitrage while also assisting members with implementing the Proposed Amendments. Harmonization should extend to the definition of terms.

In our 2020 response the IIAC also outlined several IIROC defined terms that were conflicting or inconsistent with those of the Canadian Securities Administrators ("CSA"). We appreciate that:

- the Proposed Amendments address some of the definitions we identified as problematic.
- the Proposed Amendments clarify that the CSA exclusions apply irrespective of the definition used by IIROC.
- IIROC has stated that when new regulations are introduced by the CSA, IIROC will evaluate the need for amendments to its definitions and other related regulatory requirements.

The IIAC recommends clarifications or amendments be considered for the following defined terms:

Definition of “Derivative”

In our 2020 response the IIAC requested that IIROC modify the definition of “*Derivative*” to reflect the appropriate scope of these products by the CSA. Our rationale was that the proposed IIROC definition appears to inadvertently capture certain products that have been historically excluded from the definition of derivative (e.g. structured notes including PPNs, PARs etc.).

While IIROC has clarified that the CSA exclusions will apply irrespective of the definitions used by IIROC, since IIROC introduced a new definition for “Security” (A security as defined within the relevant securities law, other than a derivative), a similar statement under the definition of derivative is warranted for consistency.

The IIAC recommends, therefore, that the definition of “Derivative” include a statement at the end to the effect of “other than a Security, as defined within relevant securities law”.

Definition of “Institutional Client”

The IIAC continues to recommend that the definition of “Institutional Client” not be extended to OTC derivatives (where the term Eligible Derivatives Party is used instead). We remain concerned that without this distinction there is the risk of confusion and regulatory arbitrage. We request that IIROC reconsider its approach on the definition of institutional client.

Definition of “Hedger”

The Proposed Amendments only extend the definition of “Hedger” to non-individuals. IIROC has not explained why the definition of a hedger excludes individuals. For example, what is the rationale for excluding sole proprietorships and larger investors from engaging in hedging activities? There are exemptions provided to certain requirements where an account is a “hedging account”. For example, cumulative loss limits are not required for hedging accounts. Does a retail client need to meet the IIROC definition of a hedger for an account to be considered a hedging account, or can an individual’s account be considered a hedging account simply because it is being used for hedging purposes?

If a client must meet the definition of a hedger, then we propose expanding the definition to include individuals seeking to hedge risks associated with their wealth portfolio in the same way a non-individual engaged in business does. (For example, a high net-worth client hedging currency risk through the use of derivatives).

2. Best Execution and Fair Pricing of OTC Derivatives

Sections 3122 of the Proposed Amendments details factors for achieving best execution of OTC Derivative transactions including “fair price” determinations. Pricing of a derivatives transaction depends upon several factors that are interrelated. Given the nature of OTC derivatives transactions, the term “fair” in the context of “fair price” or “fair market value” should be interpreted to mean what is commercially reasonable in the professional judgement of the member.

3. Enhanced Account Statement Disclosures

IIAC Members appreciate the draft guidance notice pertaining to the Derivative Risk Disclosure Statement that IIROC published in conjunction with the Proposed Amendments. Section 2.3.3 of the Proposed Amendments reveals that, in certain circumstances, a Dealer Member may send to retail clients “enhanced account statement disclosures” in lieu of performance and fee/charge reports. We recommend that IIROC consult with members and then provide, for comment, sample templates or other resources to assist members in the preparation of their enhanced account statement disclosures.

4. Client Account Statements

The Proposed Amendments introduce a requirement for Dealer Members to send a daily statement to each retail client who at the end of the day has in their account: (i) an open futures contract, forward contract, contract for difference or similar derivative contract position, or (ii) an unexpired and unexercised option contract, futures contract option, or similar derivative contract position.

We view this as a significant and material change that imposes extremely onerous requirements that will be costly and challenging for dealers servicing retail clients to implement. Retail clients can review their account holdings on a daily basis, if they prefer, either online or through an Advisor/representative. This access should be sufficient in meeting the intentions of the proposed IIROC requirement.

We recommend the Proposed Amendments remove references to “send” and “statement”, and IIROC redraft the requirement to be more flexible, since this information may be provided on a website rather than a formal statement that is physically sent to every client. As a suggestion, IIROC may want to consider wording along the following: *“A Dealer Member must provide position information to each retail client who at the end of the day in their account...”*.

5. Proficiency Requirements

Some dealers may offer certain derivatives on a very limited basis such as for hedging purposes on an unsolicited basis for sophisticated high net-worth clients only. The proficiency requirements contained in the Proposed Amendments for RRs, IRs, PMs, APMs and Supervisors are extremely onerous when derivatives are being offered only under such limited circumstances. In such circumstances we recommend that IIROC include an exemption from the proficiency requirements to reflect the limited use of derivatives.

6. Reporting of Profitable Accounts

In its response to Comment #33 pertaining to the disclosure of OTC derivative accounts that were profitable, IIROC indicates that their proposal is in line with Quebec Derivatives Act requirements. However, we do not believe this to be correct. Section 11.36 of the Quebec Derivatives Regulation requires disclosure to the AMF, not to clients. Furthermore, the disclosure requirements that IIROC references in its comment related to other jurisdictions pertain specifically to OTC Leveraged Products and CDS, and not to all OTC derivatives.

We continue to have concerns over the resources required to meet this requirement. Additionally, it is not clear how an OEO client will benefit from knowing whether other OEO clients with OTC derivative accounts are profitable. We recommend, therefore, that this requirement be removed from the Proposed Amendments.

7. Business Continuity Planning (“BCP”)

We support IIROC’s decision to remove from the Proposed Amendments the earlier proposal mandating a Dealer Member to invoke its business continuity plan when a significant business disruption occurs. In its place the Proposed Amendments require Dealer Members to notify IIROC only when it encounters a significant business disruption and when it invokes its business continuity plan – regardless of the nature of the triggering event.

The significance of a business disruption or impairment and the steps a firms should take when such an impairment has occurred may be determined by the member, in the reasonable exercise of their professional judgement and are unique to the facts and circumstances of each case. IIROC Staff should acknowledge and accept the reasonable exercise of professional judgement.

8. Implementation Period

Given the scope of the Proposed Amendments and the imposition of new requirements impacting processes, procedures, documentation and systems of the Dealer, an extended implementation period greater than twelve months will likely be required. We recommend IIROC engage further with its members to ascertain workable industry timelines.

We appreciate the ongoing consultation with industry participants as our members have a vested interest in fully understanding and being able to comply with the final regulations. If you need any clarification or have questions regarding this letter, please contact the undersigned at jrand@iiac.ca. Thank you.

Sincerely,

Investment Industry Association of Canada