Cooperative Capital Markets Regulatory System

December 22, 2015

Delivered Via Email: comment@ccmr-ocrmc.ca

Dear Sirs/Madams:

Re: Comments on Revised Consultation Draft *Capital Markets Act*; CMRA Regulation 91-501 (*Derivatives and Strip Bonds*) and CMRA Regulation 91-502 (*Trade Repositories and Derivatives Data Reporting*)

The International Energy Credit Association ("**IECA**") hereby submits the comments contained in this letter on behalf of its members in response to the solicitation for comments made by the Cooperative Capital Markets Regulatory Authority ("**CMRA**") in respect of the following published documents:

- Revised Consultation Draft *Capital Markets Act* ("**Act**");
- CMRA Regulation 91-501 *Derivatives and Strip Bonds* ("**Scope Rule**");
- Proposed Companion Policy 91-501 *Derivatives and Strop Bonds* ("**Scope CP**");
- CMRA Regulation 91-502 *Trade Repositories and Derivatives Data Reporting* ("**TR Rule**"); and
- Proposed Companion Policy 91-502 *Trade Repositories and Derivatives Data Reporting* ("**TR CP**").

INTRODUCTION

The IECA is not a lobbying group. Rather, we are an association of several hundred energy company credit management professionals grappling with credit-related issues in the energy industry.

The IECA seeks to protect the rights and advance the interests of the commercial energy end-user community that makes up its membership. IECA membership includes many small to large energy companies, few of whom would be deemed to be derivatives dealers in Canada, but all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that Canadian businesses and consumers require for our economy and our livelihood.

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The IECA has included a number of comments on the Act, Scope Rule, Scope CP, TR Rule and TR CP, below. For ease of reference, the CMRA is invited to make reference to the below table of contents which sets out the Article, page number and proposed instrument on which the IECA has commented herein.

I. Definition of Large Derivatives Participant – Sections 2 and 22 of Act

The CMRA has indicated in "The Cooperative Capital Markets Regulatory System Governance and Legislative Framework" which was published on August 25, 2015 (the "**Framework Overview**"), that in considering what drafting changes it would make to the Act that "...drafting changes were made to better align the Act with the draft initial regulations and carry forward key aspects of current securities and derivatives legislation, including the Ontario *Commodity Futures Act*. For example, a definition has been added for a 'large derivatives participant'."

The IECA notes that "large derivatives participant" is defined in Section 2 of the Act as:

> "...a person who trades in derivatives and is within a class of persons that are prescribed to be large derivatives participants".

The only other reference to the defined term of "large derivatives participant" is contained in Section 22 of the Act (Requirement to be Registered), which reads as follows:

> 22. (1) A person must not act as a dealer, adviser, investment fund manager or **large derivatives participant** unless the person is registered in accordance with the regulations and in the category prescribed for the purposes of the activity. **[Emphasis Added]**

The IECA notes that the concept of "large derivatives participant" does not appear in either the Scope Rule or the TR Rule.

The IECA would suggest that the Canadian use of the category of "large derivatives participant" is analogous to the U.S. Commodity Futures Trading Commission's ("**CFTC**") category of "Major Swap Participant" for data reporting purposes. As of the date of this letter, there are currently no U.S. market participants that fit into the category of "Major Swap Participant".

The IECA would respectfully request that the CMRA provide insight into why it has included the new category of "large derivatives participant" with respect to registration requirements in the Act and which market participants (in the Canadian market) it anticipates will fall into such a category. Further, the IECA requests that the CMRA confirm, for the purpose of the Scope Rule and the TR Rule, either: (i) that it does not anticipate the inclusion of the category of "large derivatives participants" into such regulation in the future; or (ii) if such inclusion is anticipated in the future, what would be the purpose of such inclusion and why are large derivatives participants not mentioned in the current drafts of the Scope Rule and the TR Rule? Additionally, the IECA respectfully submits that, given that there are currently no Major Swap Participants in U.S. derivatives markets and that Canadian derivatives market are significantly smaller than U.S. markets, there will likely be no "large derivatives participants" in Canada and therefore this category is not needed at all.

II. Comments on the Draft CMRA Regulations vis-à-vis NI31-103 and other National Instruments – Scope Rule

In the Framework Overview, the CMRA specifies that the Cooperative Capital Markets Regulatory System, which is proposed by the CMRA for enactment by each participating province and territory, "modernizes existing provincial securities legislation and harmonizes the regulatory approaches taken by the British Columbia, Ontario, New Brunswick and Saskatchewan securities acts." The IECA notes that there are extensive references made to definitions and concepts contained in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registration Obligations ("**NI 31-103**") within the Scope Rule. The IECA would respectfully request that the CMRA provide market participants with some guidance and insight regarding how securities laws, specifically NI31-103, will interplay with the Act, the Scope Rule and the TR Rule (i.e. which pieces of legislation will be paramount to the extent that there is a discrepancy)? An example of such a discrepancy is that new NI 31-103 provides in section 1.2(2) that in Alberta and a CMR Jurisdiction a reference to "securities" in this Instrument includes "derivatives" unless the context otherwise requires. By deeming derivatives to be securities, new NI 31-103 has the effect of requiring registration before an entity may deal in or advise with respect to OTC derivatives, unless an exemption to registration applies.

III. Definition of Qualified Party (Material Component) –Section 1 of Scope Rule

The IECA supports the registration and prospectus exemptions for trades in over-the-counter ("**OTC**") derivatives where each party to the trade is a "qualified party" (as defined in the Scope Rule) or "permitted client" (as defined in NI 31-103), each acting as principal. However, in order to provide further clarity to market participants, the IECA believes that certain elements of the definition "qualified party" should be clarified.

Section (o) of the definition of "qualified party" describes what is very similar to the hedging test under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("**Dodd-Frank**"). In Section (o) the following phrase is used:

> "… provided that a **material component** of the underlying interest of the OTC derivative is…" **[Emphasis added]**.

The IECA would respectfully request that the words "material component" be defined or clarified.

IV. Definition of Qualified Party (Affiliates of Qualified Party) – Section 1 of Scope Rule

Sections (s) and (t) of the definition of "qualified party" extend that definition to upstream and downstream affiliates of entities who are qualified parties by virtue of satisfying the characteristics in other sections of the "qualified party" definition (e.g. descriptions in sections (a), (b), (c), etc.). The IECA notes that one of the few sections excluded from the extension in Sections (s) and (t) is Section (o). Under Section (o) "hedgers" (i.e. those persons that buy, sell, trade, produce, market, broker or otherwise use a commodity in their business and that enter into an OTC derivative) may be "qualified parties" but an upstream or downstream affiliate of a hedger will not be a qualified party because Sections (s) and (t) do not include reference to Section (o).

The IECA respectfully requests that the CMRA provide its rationale for excluding such affiliates from the qualified party definition.

V. Definition of Qualified Party (Obligations Fully Guaranteed) – Section 1 of Scope Rule

In Section (y) of the definition of "qualified party" in the Scope Rule, the CMRA describes a "guaranteed affiliate" concept and reads as follows:

> "a person whose obligations in respect of **the OTC derivative** are **fully guaranteed** by another qualified party;" **[Emphasis added]**

In the TR Rule and in other implemented derivatives rules and regulations in Ontario, Manitoba and Quebec respectively, the language "being responsible for the liabilities of such party" has being used as the third category of the local counterparty definition. In the TR Rule, section 1(1), definition of "local counterparty" states as follows:

> "local counterparty" means a counterparty to a transaction if, at the time of the transaction, one or more of the following apply:
>
> (a) the counterparty is a person or company, other than an individual, organized under the laws of CMR Jurisdiction or that has its head office or principal place of business in a CMR Jurisdiction;
>
> (b) the counterparty is registered under capital markets law as a derivatives dealer or in an alternative category as a consequence of trading in derivatives;
>
> (c) the counterparty is an affiliate of a person or company described in paragraph (a), and such person or company is **responsible for the liabilities of that affiliated party**; **[Emphasis Added]**

The interpretation of "responsible for the liabilities of that affiliated party" included in the TR Rule does not align with the Section (y) definition of a "qualified party" in the Scope Rule. The IECA believes that this conceptual difference in how the meaning of a "guarantee" could be interpreted under the TR Rule and the Scope Rule could create uncertainty for market participants. The IECA respectfully requests that the CMRA align these two divergent definitions with respect to guarantees in its TR and Scope Rules.

The IECA recommends that it is more clear and precise to describe the guarantee obligation as one which relates to the OTC derivative (i.e. as opposed to the general liabilities of a party), however, in order to provide further clarity to market participants, the IECA would suggest that the CMRA provide further clarity around the meaning of "fully guarantee". For example, does the concept of "fully guarantee" include limited guarantees such as those guarantees which may have a dollar value cap, guarantees which may be limited to payment and no other performance obligations, etc.?

VI. Exempt Derivatives (General and Duty to Report) – Section 3(d) of Scope Rule / Sections 25(d), 26, 27 and 40(d) of TR Rule / Section 25(d) TR CP

The IECA notes that Section 3 of the Scope Rule excludes certain derivatives from the registration and prospectus exemptions set out in the Act and Section 25 of the TR Rule excludes certain derivatives from the data reporting requirements the TR Rule. The provisions set out in the Scope Rule and the TR with respect to these exclusions are currently identical and the reader of each of the Scope Rule and the TR Rule is directed to the TR CP for guidance regarding the types of derivatives described in each of these Sections.

The IECA is concerned that over time the Scope Rule and the TR Rule may be amended and these sections may no longer be identical. In the event of this occurrence, directing the reader of the Scope Rule to the TR CP may no longer be a practical way for the CMRA to provide further guidance on the exemptions. Further, if these provisions are no longer identical, market participants may not be cognizant of the nuanced differences of the two exemptions and inadvertently fail to comply with the revised regulation. The IECA respectfully suggests that it would be prudent to create a stand-alone product determination regulation that applies to multiple CMRA regulations (specifically the Scope Rule and the TR Rule), which would serve to consolidate the exempt derivatives into one regulation thereby avoiding the risk of diverging exclusions in the future between the Scope Rule and the TR Rule.

With reference to Sections 26, 27 and 40(6) of the TR Rule, the IECA respectfully submits that inter-affiliate derivative trades should not be reportable in cases where the trade is between affiliates who are wholly owned or majority controlled by the same ultimate parent entity and the financial results of the affiliates are reported on a consolidated basis with the parent. The IECA submits that a reporting exemption for such inter-affiliate derivative trades is appropriate because such trades do not pose systemic risk to the Canadian financial system. In the Ontario Securities Commission ("**OSC**") press release regarding the amendments to the OSC Rule 91-507 *Trade Depositories and Derivatives Data Reporting*, dated November 5, 2015, it was stated that:

> "[t]he proposed amendments would eliminate reporting obligations under the TR Rule for derivatives transactions between end-user local counterparties that are affiliated with each other."

Further, in the request for comment document published by the OSC concerning OSC Rule 91-507 and Companion Policy 91-507CP, one of the key objectives of the proposed amendments to the TR Rule was to:

> "alleviate the burden of reporting obligations under the TR Rule for end-user local counterparties engaging in derivatives transactions with their end-user affiliates that are also local counterparties…"

The IECA would strongly encourage the CMRA to consider similar amendments to its TR Rule and to remove the requirement to report inter-affiliate trades.

VII. Exempt Derivatives (Physical Delivery) – Section 3(d)(i) of Scope Rule / Section 25(d)(i) of TR Rule / Section 25(d) TR CP

The IECA commends the CMRA for adding further explanation in the TR CP regarding the intention to deliver requirement set out in Section 3(d) of the Scope Rule and Section 25(d) of the TR Rule. These sections provide exemptions to registration, prospectus and data reporting requirements for physically settled commodity contracts. Both Sections read as follows:

> "a contract or instrument for delivery of a commodity other than case or currency that

(i) is intended by the counterparties, at the time of execution of the transaction, to be settled by delivery of the commodity, and

(ii) does not allow for cash settlement in place of delivery except where all or part of the delivery is rendered impossible or commercially unreasonable by an intervening event or occurrence not reasonably within the control of the counterparties, their affiliates, or their agents;"

As set out above, Section 3(d)(i) of the Scope Rule and Section 25(d)(i) of the TR Rule require that the counterparties intend to settle the contract by delivering the commodity (i.e. the "intention element"). In addition, the TR CP provides, at page 20, that the "[i]ntention can be inferred from the terms of the relevant contract as well as from the surrounding facts and circumstances" and also states that "[t]he contract as a whole needs to be reviewed in order to determine whether the counterparties' intention was to actually deliver the commodity."

Notwithstanding the guidance provided under the TR CP, the IECA requests greater clarity be provided on the intention element. Many IECA members find that the intention element is not easily discernible because of nuances in contracts that have been structured to achieve a balance in the supply and demand of a commodity as further detailed in Article VIII, below.

The IECA urges the CMRA to provide greater clarity in order to assist market participants in interpreting "intention" in the exclusion provided for in Section 3(d)(i) of the Scope Rule and Section 25(d)(i) of the TR Rule. The IECA is aware that it would be difficult, perhaps impossible, for the CMRA to provide an exhaustive list of consumer and commercial agreements, contracts and arrangements that would fall under this exclusion, however, the IECA believes that its members and other market participants would benefit greatly from an illustrative list of characteristics and factors that are common to commodities contracts intended for delivery which would provide more definitive guidance on whether such contracts would be excluded or not.

In this regard, the IECA points to the definition of "swap" provided by the CFTC under Dodd-Frank, which clarifies the forward contract exclusion from the swap and future delivery definition in its regulations. The CFTC uses the term "commercial merchandising transaction" as the bright line and thereby provides sufficient notice to the public regarding how the forward contract exclusion from the definitions of "swap" and "future delivery" is interpreted. In addition, the CFTC provided an illustrative and non-exhaustive list of characteristics and factors that are common to consumer and commercial transactions that market participants could use in determining whether their transactions fall under the swap definition. According to the CFTC, contracts with the following characteristics would not be a swap:

- does not contain payment obligations, whether or not contingent, that are severable from the agreement, contract, or transaction;

- are not traded on an organized market or over-the-counter and, in the case of consumer arrangements, does not involve an asset of which the consumer is the owner or beneficiary, or that the consumer is purchasing, or involves services provided, or to be provided, by or to the consumer; and

- in the case of commercial arrangements, are entered into by commercial or non-profit entities as principals, or by their agents, to serve an independent commercial, business, or non-profit purpose, other than for speculative, hedging, or investment purposes.

Two key characteristics in the CFTC's interpretation that distinguish these agreements, contracts, and transactions from swaps are: (i) the payment provisions of the agreement, contract, or transaction are not severable; and (ii) the agreement, contract, or transaction is not traded on an organized market or over-the-counter. Therefore, such agreements, contracts, or transactions do not involve risk-shifting arrangements with financial entities, as would be the case for swaps.

The CFTC emphasized that this interpretation is not intended to be the exclusive means for consumers, commercial and non-profit entities to determine whether their agreements, contracts, or transactions fall within the swap definition and urged that if there is a type of agreement, contract, or transaction that is not enumerated in its list, or does not have all the characteristics and factors that are listed above, including new types of agreements, contracts, or transactions that may develop in the future, the agreement, contract, or transaction would be evaluated based on its particular facts and circumstances. The CFTC interpretation also states that parties to such an agreement, contract, or transaction may seek an interpretation from the CFTC as to whether the agreement, contract, or transaction is a swap or not.

The IECA believes that the CMRA should adopt a similar approach as that taken by the CFTC and provide sufficient clarity with respect to the intention requirement in certain commodities contracts.

VIII. Exempt Derivatives (Embedded Optionality) – Section 3(d) of Scope Rule / Section 25(d) of TR Rule / Section 25(d) TR CP

The IECA commends the CMRA for adding further explanation in the TR CP to help determine the intent element of the exclusion provided for commodities contracts in Section 3(d)(i) of the Scope Rule and Section 25(d)(i) of the TR Rule. The IECA respectfully requests that the CMRA provide additional clarification in the TR CP, as set forth below.

As discussed above, the CMRA proposes to exclude any OTC derivative that is a contract or instrument "for delivery of a commodity other than cash or currency" if it satisfies: (a) Section 25(d)(i) of the TR Rule[1], which requires that the counterparties intend to settle the contract by delivering the commodity; and (b) Section 25(d)(i) of the TR Rule, which does not allow for cash settlement in place of delivery except where all or part of the delivery is rendered impossible or commercially unreasonable by an intervening event or occurrence not reasonably within the control of the counterparties, their affiliated entities, or their agents.

As noted above, the CMRA states in the TR CP, at page 20, that "[i]ntention can be inferred from the terms of the relevant contract as well as from the surrounding facts and circumstances" and also goes on to state that "[t]he contract as a whole needs to be reviewed in order to determine whether the counterparties' intention was to deliver the commodity." Regarding evidence of an intention to deliver, the CMRA indicates in the TR CP, at page 20, that:

[1] Note: In this Article IX, all references to Section 25 of the TR Rule are also applicable to Section 3 of the Scope Rule.

"...the contract must create an obligation on the counterparties to make or take delivery of the commodity and not merely an option to make or take delivery.... **a contract containing a provision that permits the contract to be settled by means other than delivery of the commodity, or that includes an option or has the effect of creating an option to settle the contract by a method other than through the delivery of the commodity, would not satisfy the intention requirement and therefore does not qualify for this exclusion**." **[Emphasis added.]**

However, the CMRA continues on to note that:

"We are generally of the view that certain provisions, including standard industry provisions, the effect of which **may** result in a transaction not being physically settled, **may not necessarily negate the intention to deliver**. The contract as a whole needs to be reviewed in order to determine whether the counterparties' intention was to actually deliver the commodity. **Examples of provisions that may be consistent with the intention requirement under paragraph 25(d)(i) include:**

- **an option to change the volume or quantity, or the timing or manner of delivery, of the commodity to be delivered;**
- **a netting provision that allows two counterparties who are party to multiple contracts that require delivery of a commodity to net offsetting obligations provided that the counterparties intended to settle each contract through delivery at the time the contract was created,**
- **an option that allows the counterparty that is to accept delivery of a commodity to assign the obligation to accept delivery of the commodity to a third-party; and**
- **a provision where cash settlement is triggered by a termination right arising as a result of the breach of the terms of the contract or an event of default thereunder.**

Although these types of provisions permit some form of cash settlement, they are included in the contract for practical and efficiency reasons." **[Emphasis added.]**

The CMRA also states, at page 21 of the TR CP, that:

"[w]hen determining the intention of the counterparties, we will examine their conduct at execution and throughout the duration of the contract. Factors that we will generally consider include **whether a counterparty is in the business of producing, delivering, or using the commodity in question and whether the counterparties regularly make or take delivery of the commodity relative to the frequency with which they enter into such contracts in relation to the commodity**." **[Emphasis added.]**

The CMRA then goes on to specify, also on page 21 of the TR CP that:

"[p]aragraph 25(1)(d)(ii) requires that a contract must not permit cash settlement in place of delivery unless physical settlement is rendered impossible or commercially unreasonable as a result of an intervening event or occurrence not reasonably within the control of the counterparties, their affiliates nor their agents."

The IECA wishes to inform the CMRA that many of the supply contracts regularly and routinely used by energy companies may provide for the sale and physical delivery of petroleum, natural gas, electricity and other non-financial commodities provide for zero or nominal delivery of the commodity at various times during the term of such contracts. We provide the following examples of arrangements common in the energy industry:

(a) Firm, variable contracts, also known as peaking deals – in these types of contracts, the seller is obligated to deliver a quantity of natural gas that the buyer, at its sole election, wishes to take or the buyer is obligated to take a quantity of natural gas that the seller, at its sole election, wishes to deliver. The quantity of natural gas in these contracts ranges from zero to a set maximum amount because of the variability of the need or supply of natural gas experienced by the buyer or seller, respectively; and

(b) Carbon offset transactions – the seller of carbon credits contracts for the option to deliver zero or a nominal amount of carbon credits during a delivery period because the seller may not generate any carbon credits that would be available for delivery during the delivery period. Similarly, a buyer of carbon credits may contract for the option to take zero or a nominal amount of carbon credits because its level of operations may not give rise to carbon offset regulatory obligations during the delivery period.

(c) Asset management arrangements ("**AMAs**") – represent contractual arrangements sanctioned under the U.S. Federal Energy Regulatory Commission ("**FERC**") Order 712 -*Promotion of a More Effective Capacity Release Market.* Under that Order FERC permits market-based pricing for short-term natural gas pipeline capacity releases. This facilitates asset management arrangements which enhance competition in the secondary natural gas pipeline capacity release market and increase shipper gas supply options. In general, AMAs are "commercial contractual relationships" where a party agrees to *manage* gas supply and delivery arrangements, including transportation and storage capacity for another party for a payment. These arrangements might result in zero volumes of natural gas actually being delivered but the volumetric optionality is required by FERC. The optionality must be a term of the arrangement, even though the party that benefits from the optionality might never intend on using it. Canadian pipeline companies transporting natural gas to U.S. hubs are subject to this FERC Order. In the U.S. these AMAs have been categorically excluded from the definition of "swaps". The IECA would respectfully request that the CMRA specifically add AMAs to the list of excluded derivatives in Section 3 of the Scope Rule and Section 25 of the TR Rule.

Based on the text of Section 3(d) of the Scope Rule and Section 25(d) of the TR Rule, as well as the CMRA's clarification regarding embedded optionality provided in the TR CP, the IECA is concerned that such physical commodity supply contracts may not qualify for the exclusion provided in Section 3(d) of the Scope Rule and Section 25(d) of the TR Rule as contracts that are intended by the counterparties to be settled by delivery of the commodity, solely because of zero or nominal delivery obligations at various times during the term of such contracts could be interpreted as failing to satisfy the intention element.

The IECA, therefore, respectfully requests that the CMRA add the following clarification, or similar provision, to the TR CP:

"Including the ability to take zero or nominal delivery in an agreement, contract or transaction for the purchase or sale of petroleum, natural gas, electric energy, or any other non-financial commodity will not cause such agreement, contract or transaction to fail to satisfy the exclusion under Section 3(d)(i) of Regulation 91-501 and/or Section 25(d) of Regulation 91-502, so long as that agreement, contract or transaction (i) is intended to be settled by physical delivery of the commodity once a delivery or purchase obligation arises; and (ii) is between two counterparties in the business of producing, delivering, marketing or using the commodity in question."

IX. Registration and Prospectus Exemptions – Section 10 of Scope Rule

Section 10 of the Scope Rule states that:

"[t]he registration requirement and the prospectus requirement do not apply in respect of a trade in an OTC derivative where each party to the trade is a permitted client or qualified party, **each acting as principal**." **[Emphasis added.]**

The IECA wishes to inform the CMRA that many IECA members have centralized derivatives trading affiliate corporate structures that may potentially disqualify them from the registration and prospectus exemption provided in Section 10 of the Scope Rule. The IECA would respectfully suggest that this was not the initial intention of the CMRA. To illuminate the IECA's concern, please consider the following example, to which the IECA shall refer to as the "Sleeving Example":

A group of four affiliated entities each individually owns a factory for the manufacture of widgets ("**ProductionCos**"). The ProductionCos are all wholly owned or majority owned by the same "ParentCo" and their financial results are reported on a consolidated basis with ParentCo. ParentCo also provides credit support (through guarantees and/or letters of credit) for the ProductionCos, as and when needed.

The four factories require electricity and natural gas to operate. To procure electricity and natural gas, and to hedge against commodity price volatility, the ProductionCos desire to enter into forward contracts for the physical supply of electricity and natural gas and financial derivatives contracts related to those commodities. Each ProductionCo could transact in the market directly with other derivatives market participants to obtain such commodity derivative transactions and would be considered a "qualified party".

Rather than having each ProductionCo transact on its own behalf, their corporate family has another affiliate, "TradeCo", whose function is to transact derivatives on behalf of the entire corporate family, either as a disclosed or undisclosed agent. TradeCo is also wholly or majority owned by ParentCo, its financial results are reported on a consolidated basis with ParentCo and ParentCo provides credit support, as and when needed.

TradeCo was established to make negotiating, entering into, and administering the corporate family's derivatives activities more efficient. TradeCo is also a "qualified party". It is more efficient and cost effective for one member of the corporate family to negotiate, execute and administer derivatives trades with external parties than to have four ProductionCos each have to negotiate, enter into, and administer such agreements. TradeCo may also trade derivatives with external parties for its own account.

> After TradeCo has entered into an "outward facing derivative trade" with an external party as disclosed or undisclosed agent for a ProductionCo, any profits or losses associated with such trade are recorded in the financial ledgers of the relevant ProductionCo on a monthly, quarterly, or annual basis simply by means of accounting entries, rather than by the actual exchange of funds. There may or may not be written agreements in place, including trade confirmations, between ProductionCos and TradeCo and each outward facing derivatives trade may or may not have an exactly corresponding inter-affiliate trade. On a monthly, quarterly, or annual basis, the financial results of the ProductionCos and TradeCo are rolled up into ParentCo and reported on a consolidated basis.

The IECA would respectfully request that the CMRA provide clarification and guidance to market participants with respect to Section 10 of the Scope Rule. Specifically, with reference to the Sleeving Example, the IECA would request that the CMRA make clear that while the "acting as principal" requirement set out in Section 10 is applicable to a number of market situations, it does not apply to those market participants who have centralized derivatives trading affiliate corporate structures in which a trading affiliate acts as a disclosed or undisclosed agent (the "**Agent**") on behalf of one or more affiliated qualified party(ies) (the "**Principal(s)**") with respect to OTC derivatives, when the Principals for which the Agent acts would not have to either register or file a prospectus if they entered into such trades on their own account. In other words, the IECA requests that the CMRA please clarify that in the Sleeving Example and in the context of Section 10 of the Scope Rule: (i) the Agent will not be subject to the registration or prospectus requirement by virtue only of it acting as a disclosed or undisclosed agent in a trade in an OTC derivative on behalf of the Principal(s); and (ii) the Principal(s) will not be subject to the registration or prospectus requirement by virtue only of the fact that the Principal(s) trade OTC derivatives through the Agent.

X. Definition of Derivatives Dealer (General) – Section 1(1) of the TR Rule

The definition of "derivatives dealer" in the TR Rule is as follows:

> " 'derivatives dealer' means a person engaging in or holding himself, herself or itself out as engaging in the **<u>business of trading in derivatives</u>** in a CMR Jurisdiction as principal or agent;" **[<u>Emphasis Added</u>.]**

On a fundamental level, the IECA submits that the concept of being "in the business of trading in derivatives", that was borrowed from securities markets and lies at the heart of the derivatives dealer definition in the TR Rule, requires significant modification and clarification in the context of derivatives markets. Derivatives markets are fundamentally different from securities markets in many key respects. Therefore, concepts applicable to securities markets, such as elements determinative of a securities dealer, when applied with only superficial changes to elements determinative of a derivatives dealer, are poorly suited to derivatives markets. The IECA would welcome the opportunity to meet with the CMRA to discuss these issues more substantively in the future.

In addition, the IECA respectfully requests that the CMRA please clarify whether, in determining if a party is a derivatives dealer for the purposes of the TR Rule, the term "derivatives" as used in the derivatives dealer definition includes or excludes the "excluded derivatives" identified in Section 3 of the Scope Rule and Section 25 of the TR Rule. In other words, in determining whether a party is a derivatives dealer or not, should a party consider its activities with respect to either, or both, reportable and/or excluded derivatives or just reportable derivatives? The IECA submits that, logically, only reportable derivatives should be considered and therefore derivatives that are not reportable should be irrelevant to determining dealer status and who has to report.

XI. Reporting Counterparty (Written Agreement) – Section 26(1) of the TR Rule

Section 26(1) of the TR Rule is as follows:

> "The reporting counterparty with respect to a transaction involving a local counterparty is
>
> (a) if the transaction is cleared through a recognized or exempt clearing agency, the recognized or exempt clearing agency,
>
> (b) if paragraph (a) does not apply to the transaction and the transaction is between two derivatives dealers, the derivatives dealer determined to be the reporting counterparty **under a written agreement** between the counterparties,
>
> (c) if paragraph (a) does not apply to the transaction and the transaction is between a derivatives dealer and a counterparty that is not a derivatives dealer, the derivatives dealer,
>
> (d) if paragraphs (a) to (c) do not apply to the transaction, the counterparty determined to be the reporting counterparty **under a written agreement** between the counterparties, and
>
> (e) in any other case, each local counterparty to the transaction." **[Emphasis Added.]**

The IECA supports the proposed hierarchy in the reporting counterparty waterfall in Section 26(1) of the TR Rule. The IECA believes that the hierarchy properly allocates reporting responsibility, as among various categories of derivatives market participants, to those best suited to fulfil the reporting responsibilities. However, the IECA notes that if Subsections (a) – (d) of Section 26(1) do not apply, the reporting counterparty with respect to that transaction is "…each local counterparty to the transaction". Further, as drafted, the proposed hierarchy in the reporting counterparty waterfall assumes that there will always be a written agreement between two dealers in Section 26(1)(b) or between a two non-dealers in Section 26(1)(d). It appears, therefore, that the CMRA will expect dual reporting from counterparties in the absence of a written agreement between two derivatives dealers or between two counterparties that are not derivatives-dealers. Dual reporting is not only onerous for "end-user" market participants such as the IECA membership, but where both counterparties independently report the derivatives transaction data, such double reporting also skews the trade repository data for the overall market and thus dramatically diminishes the value of the trade repository data in identifying systemically important entities and transactions.

XII. Reporting Counterparty (Jurisdiction of Derivatives Dealer) – Sections 1.1(1) and 26(1) of the TR Rule

The IECA supports the proposed hierarchy in the reporting counterparty waterfall in CMRA Regulation 91-502. The IECA believes that the hierarchy properly allocates reporting responsibility, as among various categories of derivatives market participants, in descending order from the categories that should be best suited to fulfil the reporting responsibilities to those least well suited to do so.

The IECA believes however, that to avoid any confusion under the reporting counterparty waterfall, the definition of "derivatives dealer" should be clarified to include other non-CMR jurisdictions in which an entity must be "*...engaging in the business of trading in derivatives...*" in order to be caught by the definition and thereby, *prima facie,* be deemed as the reporting counterparty in most instances. This clarification is particularly important since, as discussed above, the definition of local counterparty currently excludes non CMR and foreign registrants.

The IECA is concerned that because of the limitation of the derivatives dealer definition to CMR jurisdictions, to the extent that the CMRA Regulation 91-502 will only apply in the CMR jurisdictions, a derivatives dealer organized or domiciled outside of the CMR jurisdictions (e.g. in Montreal, Calgary or New York) could enter into a trade with a CMR jurisdiction local counterparty and argue that because of the limitation of jurisdictional specificity in the definition of derivatives dealer, it is not a derivatives dealer in a CMR jurisdiction and therefore is not the reporting counterparty under the reporting waterfall. As a result, the non-dealer CMR local counterparty would have to report the trade, even though it might not otherwise be the reporting counterparty for any other trades, and the QC, AB or NY dealer may be reporting many trades in other jurisdictions. The IECA does not believe that such an outcome is appropriate and any potential lack of clarity that could lead to such an outcome should be corrected.

To that end, the IECA submits that the derivatives dealer definition should specify that a person is a derivatives dealer if it either: (i) engages in the business of trading in derivatives anywhere in the world, or (ii) is registered as a 'dealer', 'swap dealer', or any similar classification under the derivatives regulations of any jurisdiction in the world. The IECA submits that being registered as a dealer anywhere in the world should be determinative for both the derivatives dealer definition and, by extension, the reporting counterparty waterfall under Section 26(1) of the TR Rule.

XIII. Duty to Report (Liability after delegation) – Section 27(3) of TR Rule

Section 27(3) of the TR Rule reads as follows:

> "A reporting counterparty may delegate its reporting obligations under this Regulation, but remains responsible for ensuring the timely and accurate reporting of derivatives data required by this Regulation."

The effect of this requirement is that it will create additional and onerous obligations on the non-reporting counterparty. The non-reporting counterparty will, at a minimum, need to ensure that it has the personnel and system-resources in place to be in a position to review all of the data submitted by the reporting counterparty. This requirement represents a significant cost. Precluding non-reporting counterparties from relying on delegation may create more costs to build the systems and processes required to monitor the reporting counterparty's compliance than for the non-reporting counterparty to simply report the derivatives data themselves. The obligation set out in Section 27(3) of the TR Rule may ultimately lead to a situation whereby there is "dual reporting" of derivatives data by the counterparties.

XIV. Exclusions (Threshold) – Section 41 of TR Rule

The IECA commends the CMRA for proposing Section 41 of the TR Rule to provide an exclusion from the reporting obligation with respect to certain derivatives transactions. Section 41 reads as follows:

Despite any other section of this Regulation, a local counterparty is under no obligation to report derivatives data for a transaction if,

(a) the transaction relates to a derivative the asset class of which is a commodity other than cash or currency,

(b) the local counterparty is not a derivatives dealer; and

(c) the local counterparty has less than $● **[to be determined]** aggregate notional value, without netting, under all its outstanding transactions at the time of the transaction including the additional notional value related to the transaction.

The IECA respectfully requests that the CMRA use a threshold of at least $3.0 billion (CAD) in order to grant meaningful relief to commodity producers, processors and consumers. The IECA also respectfully requests that the CMRA describe the methodology for the future analysis which is to be conducted by staff of the CMRA regarding its proposed threshold so that a more comprehensive review of Section 41 of the TR Rule and TR CP can be made by the IECA and other interested members of the public.

As well, the IECA would respectfully request that the CMRA specify in the TR CP that those transactions which are already cleared on an exchange need not be included when determining the "aggregate notional value" referenced in Section 41(c). The IECA notes that the purpose of requiring market participants to report derivatives data is to ensure transparency in the OTC derivatives market. Given that any trades which are cleared will automatically be reported and made publicly available, there is no need to include such trades in the aggregate notional value determination for the purposes of the exclusion in Section 41 of the TR Rule. Further, the IECA would respectfully request that the CMRA give detailed guidance to market participants regarding exactly what OTC derivatives transactions should be included in their calculation of "aggregate notional value" for the purposes of the Section 41 exclusion. In particular, the IECA submits that only reportable derivatives transactions should be considered and that non-reportable derivative transactions should not be counted as part of determining aggregate notional value.

XV. Exclusions (Identity of Counterparty) – Section 41 of TR Rule

The IECA notes that one of the criteria which must be met to rely on the exclusion set out in Section 41 of the TR Rule is that "the local counterparty is not a derivatives dealer". The IECA requests that the CMRA specifically permits parties to rely on a representation of the counterparty with which it is trading as to its status as a derivatives dealer. By way of example, the CFTC permits safe harbor provisions with respect to the duty to verify that a counterparty is an eligible contract participant based on specified counterparty representations. Therefore, the IECA requests that the CMRA specifically articulate in the TR CP with respect to Section 41 that a counterparty may reasonably rely on representations of the other counterparty to ensure that the local counterparty is not a derivatives dealer.

CONCLUSION

The IECA appreciates the opportunity to table our members' comments and concerns to the CMRA. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member.

Yours truly,

INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/

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