December 16, 2015

DELIVERED BY EMAIL TO: commentonlegislation@ccmr-ocrmc.ca

To: The Cooperative Capital Markets Regulatory System

Dear Sir/Madam:

**Revised Draft Capital Markets Act and Draft Initial Regulations**

We are writing to provide comments on the Revised Draft Capital Markets Act ("draft CMA") and the Draft Initial Regulations released for consultation on August 25, 2015.

Established in 1894, the Canadian Life and Health Insurance Association (CLHIA) is a voluntary trade association that represents companies which together account for 99 per cent of Canada's life and health insurance business. The industry, which provides employment to about 150,000 Canadians and has assets in Canada of over $721 billion, protects about 28 million Canadians through products such as life insurance, annuities, registered retirement savings plans, disability insurance and supplementary health plans. It pays benefits of almost $84 billion a year to Canadians and manages about two-thirds of Canada's pension plans.

Our main concern with the draft CMA continues to relate specifically to the definition of "security" and the need to maintain a harmonized regulatory approach for insurance products under insurance legislation. More specifically, the first part of our letter sets out the reasons why it is inappropriate to treat individual variable insurance contracts (IVICs) as securities and outlines some of the ongoing work in this area by insurance regulators.

The second part of this letter comments on the provisions of the draft CMA and Draft Initial Regulations relating to the importance of carrying forward existing registration and prospectus exemptions on which insurers rely, discusses the proposed regulations related to derivatives regulation, and comments on the importance of cooperation with non-participating jurisdictions.

## I. Definition of "Security" and Exemption for IVICs

We continue to have concerns regarding paragraph (f) in the proposed definition of "security" in the draft CMA. That paragraph includes the words "unless otherwise provided by the regulations",

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which would allow the Participating Jurisdictions to absorb IVICs under securities law. It continues to be our strongly held position that IVICs should be solely regulated by insurance regulators. Given the oversight of IVICs by insurance regulators, allowing the Participating Jurisdictions to absorb IVICs under securities law would be duplicative, unnecessary, and inappropriate. As such, the words "unless otherwise provided by regulation" should be removed from paragraph (f).

As we indicated in detail in our letter of November 19, 2014, the regulation of securities has been separate from the regulation of insurance due to the very different considerations applicable to securities as compared to policies of insurance. It is in recognition of these differences that securities and insurance contracts have historically been subject to separate but equally stringent regulatory regimes.

Life and health insurers and IVICs are subject to a robust regulatory framework established by federal and provincial insurance laws. The federal regime contains corporate governance and audit provisions and regulatory prudential requirements which include actuarial reserves and minimum capital requirements to cover the maturity, death benefit and income guarantees associated with IVICs, features not found in mutual funds. The provincial regime contains rules regarding contract prohibitions against unfair and deceptive acts and practices, and proficiency standards for life insurance agents.

Further, the CCIR has undertaken in its 2014-2017 Strategic Plan to review the regulatory landscape of IVICs to assess potential regulatory arbitrage between IVICs and mutual funds. Key issues on which the CCIR is working towards further harmonization between mutual funds and segregated funds include: reporting of annual charges and compensation, reporting of investment performance; requirements for updating client information; standard of care; responsibility and internal control structure, and risk classification methodology.

We are therefore of the view that the additional layer of securities regulation which could flow from the definition of security in paragraph (f) is unnecessary, would create a significant amount of duplicative regulation, would increase the cost to consumers, and would be contrary to one of the stated purposes of the CMRA, which is to reduce the number of regulators and the associated regulatory burden.

With respect to the process to be followed before such regulations could be made, we appreciate the revision to subsection 202(2) of the draft CMA to state that the Authority may not make a regulation with respect to paragraph (f) in the definition of "security" unless requested by the Council of Ministers in accordance with section 211. The Summary of Comments Received and Ministerial/Regulatory Responses document released on October 20, 2015 states that it is anticipated that any such request to consult and consider making a regulation would involve consultation with insurance regulators to avoid unnecessary duplication or overlap of requirements.

From a technical perspective, we note the Commentary on the draft CMA references the approval formula in Article 5.5 of the Memorandum of Agreement Regarding the Cooperative Capital

Markets Regulatory System. A correction may be needed since article 5.3 is entitled, "Voting on a Request to CMRA to consult on and consider making a Regulation" whereas article 5.5 is entitled, "Voting on a Proposal to amend Provincial and Territorial Legislation". We presume you mean that it would be appropriate to require approval from each Major Capital Markets Jurisdiction (i.e., currently both British Columbia and Ontario) as is required in article 5.5, before proceeding to propose any regulations related to segregated funds. Consequently, adjustments must be made here to clarify that this would indeed be the case.

By way of summary, while requiring more stringent government approvals to propose and enact regulations related to IVICs is an important process improvement, this does not address the fundamental reality that IVICs are distinct from mutual funds and already subject to a robust regulatory regime. Therefore, they should not fall under the ambit of the CMA.

## II. Other Comments On the Draft CMA and Draft Initial Regulations

Prospectus Exemptions in NI 45-106

To date, regulations have not been published that would incorporate the current prospectus exemptions now found in NI 45-106. In this context, it is important that when such regulations are made they include the variable insurance contract exemption in section 2.39 of NI 45-106. Specifically, that section provides that the prospectus requirement not apply to a distribution of a variable insurance contract by an insurance company if the variable insurance contract is: (a) a contract of group insurance, (b) a whole life insurance contract providing for the payment at maturity of an amount not less than 75% of the premium paid up to age 75 years for a benefit payable at maturity, (c) an arrangement for the investment of policy dividends and policy proceeds in a separate and distinct fund to which contributions are made only from policy dividends and policy proceeds or (d) a variable life annuity.

Insurers also rely on the accredited investor exemption and the minimum amount exemptions. We would request that these exemptions also be carried forward.

Exemption from registration requirement, financial institutions

The exemption from registration requirements now contained in section 35.1 of the Securities Act (Ontario) applicable to certain financial institutions including insurance companies, is not reflected in the draft CMA. The Commentary explains that this deletion reflects a policy decision that is consistent with the approach taken in existing securities legislation in other CMR jurisdictions. While no specific exemption is included, financial institutions will nonetheless be able to avail themselves of a number of registration exemptions contained in the proposed CMA regulations. In this context, we are pleased that the proposed revised National Instrument 31-103, Registration Requirements, Exemptions and Ongoing Registrant Obligations, contains an exemption for variable insurance contracts. That being said, it is unclear how the registration exemptions in NI 31-103 would interact with the various prospectus exemptions in NI 45-106. For greater clarity, we would request that the general exemptions from registration in section 35.1 of the Securities Act (Ontario) be carried forward.

Derivatives Regulation

The requirement in section 22 of the draft CMA that a person must not act as a large derivatives participant unless the person is registered, together with the broad definition of "trade" in section 2, could potentially result in an insurer being captured under the CMA. We are of the view that regulation in the area of derivatives should distinguish between institutions that make a market in derivatives (typically banks that act as dealers) and end-users that generally use derivatives to hedge risks to which they are exposed. To require a participant in the derivatives market to register based solely on the size of their derivatives book is inconsistent with this approach and creates an additional regulatory burden associated with what is a sound risk management practice.

Existing National Instrument 91-507 sets out a hierarchy to determine which party to a transaction is required to report a derivatives transaction. The hierarchy defaults to "the ISDA methodology". The International Swaps and Derivatives Association ("ISDA") has created a Canadian Representation letter to which parties can adhere through an online portal to allocate reporting responsibilities to one of the parties. The corresponding draft CMRA Regulation 91-502 does not refer to the ISDA methodology, but rather, requires the parties to enter into "a written agreement" which is to be "kept in a safe location and in a durable form and provided to the regulator within a reasonable time following request". Entering into a separate written agreement with each counterparty would be a cumbersome and costly process. The ISDA methodology permits parties to make a one-time election with all of its counterparties to follow a particular reporting protocol. We encourage the Participating Jurisdictions to incorporate the ISDA methodology language or to confirm that adhering to the Canadian Representation letter online would satisfy the requirement to enter into a written agreement.

Trades with affiliated entities are required to be reported under the proposed regulations. We note that on November 5, 2015 the Ontario Securities Commission (OSC) issued proposed amendments to the Trade Repositories Rules which would alleviate certain reporting requirements with respect to trades between end-users, counterparties and their Canadian affiliates. We agree that trades with affiliates should continue to be exempted but, given the increasingly international nature of Canada's financial institutions we suggest that consideration be given to exempting trades between end-users and their affiliates regardless of jurisdiction. At a minimum, we would request a delay in the effective date of such trade reporting requirements as it would take time (and expense) to implement the technology and conduct the training required to report these trades.

Cooperation with Non-participating Jurisdictions

It is very important that an interface be developed for interaction and cooperation with non-participating jurisdictions to avoid creating a regulatory system that is even more fractured. We have noted that numerous sections of both NI 33-109, Registration Information, and NI 31-103, Registration Requirements, Exemptions and Ongoing Registrant Obligations, state that various provisions will be developed when determining the interface to be established between the CMR jurisdictions and other jurisdictions. The Commentary states that "the CMRA will use its best

efforts to negotiate and implement an interface mechanism with non-participating jurisdictions such that the CCMR is effectively of national application". An appropriate interface mechanism will be a key component in ensuring that securities rules are consistent across the country and it may be desirable that the cooperative regime not go into effect until an agreement relating to interface is in place. To proceed otherwise invites the possibility of post-implementation revision with its associated costs and lack of certainty.

Consistent with this approach, it would seem logical to carry forward the existing CSA framework for discussion and development of policies to be adopted by all jurisdictions.

Should you have any questions regarding our comments, please contact me (416-359-2044 or fzinatelli@clhia.ca) or my colleague James Wood (416-359-2025 or JWood@clhia.ca).

Yours very truly,

*"Frank Zinatelli"*

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