AUTORITÉ DES MARCHÉS FINANCIERS

RESPONSES TO PUBLIC COMMENTS

OVERSIGHT OF DERIVATIVES MARKETS IN QUÉBEC

February 2nd, 2007

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AMF's Response to Comment Letters

On May 25, 2006, the Autorité des marchés financiers published a consultation document entitled "Regulation of Derivatives Markets in Quebec" which set out the regulatory framework for proposed legislation of Quebec's burgeoning derivatives markets.

The Autorité published on its web site thirteen comment letters received from interested parties in Canada and the United States.

- Canadian Advocacy Committee of the CFA Societies of Canada and Montreal CFA Society
- Canadian Bankers Association (CBA)
- CSI Inc.
- Futures Industry Association (FIA)
- Institute of Canadian Bankers
- International Swaps and Derivatives Association, Inc. (ISDA)
- Investment Dealers Association of Canada (IDA)
- Investment Funds Institute of Canada (IFIC)
- Kenneth G. Ottenbreit and Terence W. Doherty
- Mouvement des caisses Desjardins
- Options Clearing Corporation (OCC)
- Société Générale (Canada)
- TSX Group Inc.

This document summarizes the comments received into the following ten subject areas and sets out the Autorité's response to each subject.

Cooperation with other jurisdictions

Comments from the IDA

"[…] The establishment of a new regulatory framework for the derivatives market must not make the systems in force in Canada's various jurisdictions incompatible or unmanageable in the context of the coordination mechanisms that currently exist between regulators. The IDA encourages the AMF to indicate its orientations clearly in this regard […].

Should it, in effect, prove possible to develop a regulatory framework that can effectively be harmonized with Ontario's, the IDA would like the Québec authorities to take the initiative of proposing that the other Canadian jurisdictions adjust their own legislative and regulatory instruments to what will, at that point, constitute the essential reference in Canada in the matter of derivatives."

Our response

We fully agree with these two points.

AMF staff regularly exchange with the various securities regulators in Canada, particularly the OSC, as well as with the *Ontario Commodity Futures Act Advisory Committee*, which recently conducted an in-depth review of the *Commodity Futures Act*. We are fully mindful that any future Québec legislation regarding derivatives must not in any way be inconsistent or contradict derivatives legislation in other jurisdictions and must be as harmonized to the greatest possible degree across Canada.

In fact, given the Montreal Exchange's specialization in the area of derivative instruments since 1999, the AMF must develop an innovative regulatory framework that could serve as a model for other provinces. This is at the heart of the proposed framework for the Québec derivatives market.

Comments from the CAC, IFIC and the FIA

"The CAC is disappointed that the AMF has not integrated their efforts to better regulate the derivative sector with those of other regulators in Canada. The CAC has a clear preference for one set of regulatory rules to apply to market participants, regardless of the province in which they carry on capital markets activities. Although the CAC does not have a firm position on the best method to achieve this consistent set of rules, we believe that derivative products and market participants should be regulated in the same manner across the country. We would encourage the AMF to work closely with the other regulators in Canada in taking the next steps contemplated in the AMF paper."

"The FIA recommends that the AMF work towards harmonizing the registration regime across Canada for both domestic and non-Canadian firms. The current regulatory framework in Canada applicable to non-Canadian dealers and

advisers is fragmented and with inconsistent provincial requirements which add to the regulatory burdens and costs for international firms wishing to participate in the Quebec and Canadian markets."

According to the IFIC, "it would be beneficial to the industry to have harmonized rules across the country. For this reason, we recommend that the AMF should consider moving forward with changes to the regulation of the derivatives market only if it does so in concert with its other colleagues on the Canadian Securities Administrators."

Our response

Far from operating independently, securities regulators in Canada, through the CSA, have for a number of years been working together on joint projects such as the registration reform project. While the project for developing a regulatory framework for the derivatives market in Québec seeks to develop new Québec regulations related to derivatives (law, regulations and policy statements), we fully concur with the comments regarding the harmonization of rules across the country and are working closely with our counterparts on this issue.

We acknowledge the importance of international derivatives markets, and consult with foreign derivatives and securities authorities, notably in the United States and the United Kingdom. We are involved in the work carried out by various international organizations, among them the IOSCO, in connection with the globalization of financial markets.

Definitions

Comments from the IDA

"In principle, this approach [of a broad definition of derivatives and of exemptions to instruments traded between sophisticated investors] seems appropriate and deserves to be explored. It is however possible that it will raise complex and delicate issues when the time comes to draft the legislative and regulatory texts. For example, the mere inclusion of derivatives that are mainly used by institutions under federal jurisdiction within the scope of a provincial law could be interpreted as ultra vires by the courts, even if the same law provides exemptions applicable to these institutions and their transactions."

Comments from the Canadian Bankers Association

"As regards regulated and OTC derivatives markets, the CBA does not support the recommendation for adopting a broad definition of derivatives that would include all existing and future derivatives contracts. Such an approach would encroach on other jurisdictions. In fact, a broad definition generates uncertainty in commercial trades and tends to encompass various transactions that are not fundamentally within the purview of the AMF.

It would be astonishing to justify supporting, based on an alleged jurisdiction over securities, the exercise of regulatory authority over products as diverse as banking products and commodity derivatives.

To ensure that the new derivatives framework does not cover mutual funds and non-redeemable investment funds, we believe that the definition of a derivative should specifically exclude securities issued by mutual funds and non-redeemable investment funds. It should also exclude instruments that do not fall under the definition of "specified derivative" in Part I of NI-81-102.

The CBA increasingly supports the recommendations contained in the Ontario Advisory Committee's interim report."

Comments from the FIA

"The FIA submits that the AMF should consider a narrower definition of derivatives to clearly avoid regulatory uncertainty associated with overlapping securities, banking or other regulations and to avoid, for example, "prospectus" issues in the futures markets."

Comments from TSX Group

"[…] Although a prescriptive definition of "derivative" that would give rise to frequent legislative amendments is not advocated by TSX Group, we believe the AMF's proposal […] is overly broad, giving rise to interpretive challenges and the potential for duplicate regulation.

For example, the breadth of the proposed definition would capture commodity contracts, including derivatives, that may not be currently subject to regulation in certain other Canadian jurisdictions, or in the U.S., such as commodity contracts that are not forward or futures contracts (i.e. spot markets transactions). As well, certain differentiation between those commodity contracts that are standardized and cleared through clearing agencies versus those that are not, may be deserving of different regulatory treatment. From a commodities perspective, the determination of what constitutes a derivative is further complicated by the nature of the commodity at issue.

Briefly, from an equities perspective, Toronto Stock Exchange currently lists a number of different hybrid equity products which would fit under both the definition of "securities" under the Securities Act and "derivatives" under the proposed Working Document definition. […] we would advocate an approach that reflects a clearer division between securities, derivative-like securities and classic equity or debt derivatives and also reflects a differential treatment of commodity and security products where appropriate."

Comments from ISDA

"[…] the all-inclusive approach risks missing the very regulatory target the AMF

should be most concerned about regulating, namely, specified types of securities-based derivatives contracts entered into with a defined category of "retail customer" as an investment. An approach which provides a targeted definition of OTC derivatives would meet this goal. […]

Certain types of contracts, such as transactions subject to the Quebec *Securities Act*, contracts of insurance, and contracts of sale of electricity or gas by a regulated distributor, are exempted from compliance with all or part of the Quebec *Consumer Protection Act* (QCPA). It is likely that these types of consumer contracts are exempted because the legislator considers that such contracts are more appropriately regulated by the specialized regulatory bodies in question and that the protection afforded by the specialized legislation is sufficient to protect consumers in such situations.

When and if a new *Derivatives Act* is enacted in Quebec, it is likely that the QCPA will be amended to provide that it does not apply to derivatives entered into with consumers to which the new *Derivatives Act* would apply […]. If the new *Derivatives Act* includes an overly broad definition of derivatives then any general consumer contract providing for the future delivery of a product […] at a price agreed upon at the time of entering into the contract would be brought within the purview of the new *Derivatives Act* and lose the protection afforded by the QCPA. In our view, this would be an unfortunate result as such contracts – which bear none of the hallmarks of an investment and are clearly not being entered into for the purpose of market manipulation or securities fraud – are more appropriately regulated by consumer protection legislation and by the *Office de la protection du consommateur*.

As noted in the Ontario Report, a targeted definition of OTC derivative should also clarify that OTC contracts are not contracts of insurance or unlawful gaming contracts."

Comments from Desjardins Group

"It would be appropriate, on the one hand, to draw a clear distinction between derivatives purchased for speculation and those traded with a risk management objective. On the other hand, the proposed definition is very broad and could be interpreted to include a range of individual transactions with customers for the purpose of matching various rate- or market-related risks.

We recommend that the definition of a derivative be amended so that it does not incorporate options concluded as part of a financing or included in another financial transaction. We believe that this legislation must target derivatives sold to individuals for the purpose of speculation."

Comments from SG Canada

"SG Canada believes that the adoption of a new structure to regulate all derivative trading in Quebec based on an expanded definition of "derivative"

could, if not very carefully implemented, (a) reduce competition among financial institutions in Quebec and (b) restrict the development of creative new financial instruments in non-exchange and non-clearing house markets. Accordingly, this approach could damage the interests of Quebec investors, unless it is carefully designed to avoid inadvertently regulating those areas that are not the principal focus of the new regulatory structure.

[S]uch a broad definition [...] would cover many products not traded through exchanges or clearing houses that do not need to be further regulated by the AMF, and indeed which may not be within the jurisdiction or the expertise of the AMF to regulate.

SG Canada submits that it would also be appropriate to reconsider the inclusion of "entering into a derivative" in the definition used for Quebec of "trade" contained in Section 1.6 of National Instrument 45-106, "Prospectus and Registration Exemptions". [...] [T]he inclusion of this phrase has introduced significant uncertainty in the securities and banking industry as to the extent to which OTC derivatives, in particular, should be considered securities for the purposes of the prospectus and registration requirements.

SG Canada also notes that any extension of the *Derivatives Act* to transactions comprising the business of banking would likely interfere with the exclusive constitutional jurisdiction exercised by the Government in the Right of Canada over the business of banking."

Comments from Kenneth G. Ottenbreit and Terence W. Doherty

"We recommend that the AMF reconsider its recommendation to define "derivative" broadly and then provide exemptions because this approach will capture certain products that should not be regulated by the AMF. Instead, we support an approach that regulates and defines "derivatives" as only exchange-traded options, futures and options on futures that have standardized terms and specifications. In conjunction with such definition of "derivative", we recommend reformulating a definition of "security" under the present *Securities Act* (Quebec) which definition would exclude "derivatives" and certain OTC products entered into between sophisticated parties. Should the AMF desire to regulate OTC derivative transactions targeted at retail investors, then such regulation should be distinguished from or treated in a similar manner to derivatives. This approach is most similar to that taken in British Columbia, Alberta and Saskatchewan and is consistent with the integration of the term "derivative" under the *Securities Act* (Quebec). Furthermore, this approach will provide clarity as to what constitutes a "derivative" versus what is a "security"."

Summary of comments

According to the majority of comments, the proposed definition of a derivative is too broad, and risks having the following impacts:

- duplicate regulations (securities, derivative instruments, banking products or other) and an overlapping of jurisdictions (federal authority over the banking industry, *Régie de l'énergie* in the electricity and gas sector);
- the regulation of transactions that fall outside our jurisdiction or need not be under our jurisdiction (insurance contracts, bilateral OTC market contracts);
- the inclusion of cash market transactions;
- difficulties related to interpretation (hybrid products, commodity contracts);
- legal uncertainty with regard to commercial transactions.

Our response

The proposed definition, designed to ensure the AMF's jurisdiction over all derivative instruments, including products yet to be developed, does not put forward a list of contracts, underlying instruments or trading sites. The definition sets out the scope of the proposed derivatives legislation:

"This Act applies to derivatives, such as futures contracts, options and swaps, which constitute instruments, agreements or securities, the market price, value or payment obligations of which are derived from, referenced to or based on one or more underlying interests."

By opting for such a wide scope, the AMF is striving to cover not only all derivative instruments currently available, but also to be able to adapt to any new instruments without having to adopt legislative amendments to modify the scope of the *Derivatives Act*.

In addition, the AMF would draw on a list of specific exclusions for those products that obviously should not be considered derivative instruments. The definition's scope would thus be limited by these exclusions, which would be quite specific. The AMF would also introduce in the proposed Act a residual exclusion authority that could be exercised through regulation and would ensure flexibility for responding to market developments in a timely manner as well as excluding those new products to which the Act should not apply.

Excluded products would notably comprise insurance contracts and banking type products sold by a bank under a federal charter or by a Desjardins caisse (credit union). The AMF, moreover, has no intention of becoming involved in transactions carried out by mutual agreement between "sophisticated" institutions: such activity will only be of interest to the AMF if OTC positions are used to commit market manipulation or fraud. The AMF will also monitor the sale of derivative instruments to retail customers. These clients do not have the resources, knowledge or expertise of institutions and rely on regulatory protections. However, sophisticated participants (yet to be defined, but could be based on the definition of an accredited investor under *Regulation 45-106 respecting prospectus and registration exemptions*) do not require the same degree of protection as do small investors.

The proposed definition will be very much similar to those in the following Canadian instruments: *Regulation 44-101 respecting short form prospectus distributions*, *Regulation 44-102 respecting shelf distributions*, *Regulation 55-103 respecting insider reporting for certain derivative transactions (equity monetization)* and *Regulation 81-102 Mutual Funds*.

Similarly, the approach we have selected is not far from the definition in the proposal for *Uniform Securities Act*, which reads as follows:

"Derivative means
(a) a right or obligation to make or take future delivery of
i) a security,
ii) a currency,
iii) a mineral, metal or precious stone,
iv) any other thing or interest if a unit of that thing or interest is naturally or by custom treated as the equivalent of any other unit,
v) cash, if the amount of cash is derived from, or by reference to, a variable, including,
A) a price or quote for anything included in subclauses (i) to (iv),
B) an interest rate,
C) a currency exchange rate, or
D) an index or benchmark, or
(b) any instrument or interest that is designated under section 1.7 [Designations], or in accordance with the rules, to be a derivative,
but does not include a right, obligation, instrument or interest that is designated under section 1.7 [Designations], or in accordance with the rules, not to be a derivative;"

Several comments recommend adopting the approach proposed by the *Ontario Commodity Futures Act Advisory Committee*:

"The legislation must define the types of contracts covered with reference to more generic qualities. An essential feature of CF contracts is that they are entered into on an exchange under basic contract terms set by the exchange.

The Committee is continuing to consider the elements of an appropriate definition of "commodity" and "commodity contract"."

The Ontario Advisory Committee proposes a definition that is limited to contracts traded on a regulated exchange, the terms of which are set by the exchange or clearing house. This approach appears valid for overseeing regulated markets, yet it would not enable the AMF to act in OTC markets in the event of manipulation nor to exercise jurisdiction over the sale of these products to small investors.

The AMF does not wish to regulate OTC markets for sophisticated users. However, protecting small investors and detecting instances of manipulation require a certain degree of authority to intervene in these markets. The AMF understands that such an approach should include exclusions. The proposed definition is not unanimously supported. We therefore intend to continue discussions with the goal of establishing a framework that protects investors users of derivatives, promotes Québec OTC markets, provides the certainty that is necessary for market and transaction efficiency and enables the AMF to fully realize its mission.

An alternative solution has been proposed, which consists of considering two possible definitions: one for exchange contracts, the other for OTC contracts. We could also identify end users, as proposed, as well as the use of the instrument (purely for hedging, speculating or both). Regardless of the choice made, we believe that the key will lie in a harmonized solution for Québec and Ontario.

Sophisticated investors

Comments from TSX Group

"[...] we would encourage the AMF, in particular from a commodity markets perspective, to consider sophisticated (non-retail) marketplaces engaged in exchange-trading. [...] TSX Group advocates that appropriate exemptions be available to sufficiently sophisticated participants (and to the exchanges or clearing agencies through which such participants are trading) where the trading is occurring on a principal-to-principal basis, which approach would align with certain other Canadian jurisdictions and with the approach of the CFTC in the U.S."

Comments from ISDA

"[…] ISDA urges the AMF […] to exercise regulatory authority only with respect to OTC derivatives contracts entered into with a defined category of "retail customer" in respect of derivative products that are used as investments and that are not otherwise regulated as banking products or by specialized regulatory bodies, or in the event that derivatives are used to commit fraud in respect of securities or to manipulate the securities market. […]

The proposed Derivatives Act should also articulate a definition of "retail customer" in order to target more accurately the application of the rules."

Comments from Desjardins Group

"We believe that the term "small investor" should apply only to individuals, and not to corporations or similar organizations that regularly trade in derivatives to reduce their degree of risk."

Our response

Derivatives legislation should incorporate legal authority over end users in derivative transactions, whether traded on a regulated market or not. The scope of this authority, moreover, should depend on the type of user for which the derivative instrument is intended. We propose that the legislation apply not to sophisticated users, but rather, to small retail customers. This approach was followed in the United States, under the *Commodity Futures Modernization Act of 2000*.

While we understand that OTC markets prefer the retail market definition, thereby excluding from AMF oversight individuals who are not covered by the definition, we nonetheless suggest defining sophisticated users or investors. We therefore promote the "exemption" approach over the "regulated" approach. In this sense, we are in line with the trend across North America. Our definition should clearly exclude small investors from those who regularly trade in derivatives as a hedging mechanism.

OTC markets

Comments from ISDA

"There is a vital role for the regulator to play in the derivatives market, but the regulation of the OTC derivatives market, in particular, should be risk-based and should pinpoint the critical areas of regulatory concern, *e.g.*, the need to protect certain customers in the growing market for retail OTC products that are investments and the need to deter market manipulation and fraud in the securities market. […]

Because of its extensive shortcomings, the all-inclusive approach risks missing the very regulatory target the AMF should be most concerned about regulating, namely, specified types of securities-based derivatives contracts entered into with a defined category of "retail customer" as an investment. An approach which provides a targeted definition of OTC derivatives would meet this goal."

Comments from SG Canada

"The principal concern of the Report appears to be the regulation of derivatives exchanges and clearing houses that trade in fungible and liquid derivatives available to the general public. […] In addition, the Report does not address the regulatory reasons for extending the scope of the *Derivatives Act* to entities and business relationships other than derivatives exchanges, clearing houses and related SRO's, despite potentially significant consequences in those other circumstances."

Comments from Kenneth G. Ottenbreit and Terence W. Doherty

"We believe that prospectus requirements are not appropriate for derivative products whether OTC or exchange-traded as there is no traditional type of issuer for which information would be relevant. Rather, we believe that some form of contract specification/risk disclosure document is a more appropriate method for providing information to retail investors."

Our response

The AMF's mandate consists in protecting investors and overseeing efficient market operations. Given that OTC derivative instruments can be and in fact increasingly are available to retail customers, small investors must receive all of the information necessary to make sound decisions. We therefore recommend maintaining a regulatory framework for OTC investments, including whenever appropriate, compliance with prospectus or information document requirements. In this regard, we anticipate using a predominance test, much like that of the *Commodity Futures Modernization Act of 2000*, to determine the nature of hybrid products and the necessary disclosure requirements. If a hybrid product is found to include a significant securities component, it will need to be subject to prospectus provisions.

As explained earlier, we propose regulating OTC derivative instruments in two specific instances: where these products are traded by small investors and in cases of market manipulation or fraud.

Comments from Desjardins Group

"We thus recommend that the draft Act acknowledge and protect the right to terminate transactions in the event of default and to proceed with "netting" as a risk mitigation measure."

Our response to Desjardins Group

This topic was not addressed in the discussion paper. Based on the comments received, it will be added to our upcoming research.

Regulatory approaches

Comments from the IDA

"[...] the IDA supports the proposal of developing a new law – the Derivatives Act – that would be distinct from the Securities Act. However, care will have to be taken that the distinct character of this law truly contributes to simplifying its application and clarifying the requirements in matters of compliance. Indeed, recourse to a principles-based approach is not part of the legislative tradition in the securities industry in Québec – no more than it is elsewhere in Canada. We

will need to proceed with caution and transparency in the development of the law and the prescriptive instruments that go with it."

Comments from the CAC

"The concept of using a principles-based approach to regulation has some merit. [...] Nonetheless, a principles-based approach has the real risk of being too vague or lacking sufficient guidance to be effective. [...] The CFA Institute has taken the position that [...] a combination of well thought-out principles supported with an appropriate use of rules is the most effective approach."

Comments from SG Canada

"SG Canada approves the use of core principles to provide an overall regulatory framework within which derivatives exchanges, derivatives clearing houses and SRO's operate. However, SG Canada does not believe that a "core principles" approach, without a more detailed elucidation of the application of those principles, is appropriate where there is no exchange, clearing house or SRO involved. This is particularly true in the event that the scope of instruments that fall under the *Derivatives Act* is defined broadly. It is likely that this "core principles" approach would give rise to significant uncertainty about how the *Derivatives Act* would apply to new products not traded over an exchange or through a clearing house. [...]

SG Canada does not believe that the objective of regulating trading in derivatives would necessarily be more effectively addressed through a *Derivatives Act* than under the QSA. [...] In many cases products could be considered both "derivatives" and "securities", particularly if a broad definition of "derivatives" is used for the derivatives regulatory initiative."

Comments from Kenneth G. Ottenbreit and Terence W. Doherty

"It is our view that the regulation of "securities" and "derivatives" need not be accomplished through separate statutes. [...] By enacting additional legislation, the AMF will only add to the fragmentation of financial markets legislation in Québec and Canada which may increase the costs of compliance and participation to market participants and investors. [...] Consequently, we do not support the AMF's recommendation to adopt separate legislation to regulate derivatives."

Our response

Principles-based legislation offers the necessary flexibility to respond and adapt to rapid changes in financial markets, particularly as regards derivatives. This likely explains why regulatory bodies worldwide have been opting for such a framework over the past several years, most notably the United Kingdom's Financial Services Authority and the *Financial Services and Markets Act 2000*, or

the Commodity Futures Trading Commission in the U.S. and the *Commodity Futures Modernization Act of 2000*.

Under prescriptive legislation, the regulatory body sets out both the regulations and compliance procedures. Legislation based on principles, however, separates these two elements, allowing market participants to establish procedures and demonstrate compliance. This approach would help to reduce the regulatory burden. The regulated entity would therefore be responsible for demonstrating that it is indeed adhering to the core principles, enabling the regulatory body to focus its resources on policy development and on investigations and inspections.

Principles-based legislation would be accompanied by policy statements and related regulations specifying the purpose of the stated principles in order to clearly establish the responsibilities of market participants.

We also support the development of legislation distinct from the *Securities Act*, given that derivative instruments are considered to be different from securities. At present, provisions regarding derivatives are scattered through the *Securities Act* and its related regulation. Often outdated and difficult to interpret within the current environment, the provisions have remained static over the years despite the evolution of the derivatives markets. Furthermore, such a framework would make it possible to extend the achievements made in this highly specialized area in Québec, particularly since the specialization of the Montréal Exchange in 1999. It would also strengthen the expertise developed by specialized intermediaries and in universities. Establishing new legislation would be simpler and more efficient than introducing in-depth amendments to an existing statute for the purpose of integrating a different product using a different approach.

We would like to stress our commitment to transparency throughout the development process of this new regulatory framework.

Self-certification of rules

Comments from the IDA

"First of all, self-certification of the decisions of SROs does not mean that the public regulators are abandoning their responsibilities: they may at any time condemn and invalidate the self-certified rules, even after the latter have been enforced by the SRO. They may moreover impose an amendment to the rules of an SRO in force under their jurisdiction.

[...] it is important that the SROs and the public regulators ensure the efficient circulation of information between them and devote the necessary resources to the examination a priori [...] of self-certifiable regulatory decisions. In practice, this means that the SROs working in the derivatives markets will have to find among the public regulators a sufficient number of partners with the necessary expertise to support them in their regulatory processes.

[...] An SRO with the power to self-certify its own rules must be perceived as beyond reproach in terms of its governance and the management of potential conflicts of interest [...] to which it might be exposed."

Our response

We concur.

Authorization/Recognition

Comments from the FIA

"[...] the FIA submits that : [...] Québec investors should have access to products that trade on regulated international (non-Canadian) markets without the need for the exchanges to register or the products to be qualified in Québec;

the AMF should not impose recognition or authorization requirements on international (non-Canadian) associations that regulate the activities of their members in international markets; [...]

The FIA believes that such substantive review and filing requirements are unnecessary and burdensome as these entities are subject to regulation in their home jurisdictions. Thus, the FIA does not believe that additional review and oversight by the AMF would provide additional investor protection."

Our response to the FIA

Québec investors can access international markets upon meeting the criteria under *Regulation 45-106 respecting prospectus and registration exemptions.*

The *Policy Statement respecting the authorization of foreign-based exchanges* specifies the type of framework the AMF seeks to implement with regard to foreign exchanges that it authorizes, in light of the regulation and supervision already performed by the regulatory authority in the home jurisdiction to avoid needless duplication.

Lastly, and as a corollary to the previous point, we do not intend to increase the regulatory burden of foreign entities that seek to carry on activities in Québec through an in-depth examination of their documents and monitoring of their operations where the regulatory authority in the home jurisdiction has already performs this function.

Comments from the OCC

"[...] we would urge that the proposed Derivatives Act [...] make clear that provisions requiring authorization or recognition of foreign derivatives clearing houses would not obligate a clearing house, such as OCC, that has no physical presence in Quebec and does not clear transactions in Canadian securities to be

recognized under Section 169 of the QSA, even though derivatives contracts cleared by it may be purchased and sold from time to time by Quebec residents through brokers licensed in Quebec.

[...] to the extent that a foreign derivatives clearing organization does conduct sufficient activities in Quebec to become potentially subject to recognition under provisions similar to QSA Section 169, we believe that the AMF should defer appropriately to the oversight of its home regulator and not impose duplicative, additional or conflicting regulatory requirements. Where a foreign clearinghouse is subject to comprehensive regulation in its home jurisdiction, we suggest that the AMF should have and exercise authority to exempt such a foreign clearing organization from any regulatory requirement that might otherwise apply under the Derivatives Act."

Our response to the OCC

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

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

Comments from TSX Group

"Ultimately, a system that avoids providing a material advantage being given to either domestic or foreign entities operating in Canada is the most ideal approach."

Our response to TSX Group

We concur.

Comments from Kenneth G. Ottenbreit and Terence W. Doherty

"Pursuant to the Policy Statement, the AMF proposes to require foreign-based exchanges and clearing houses to file an application [...] in accordance with the requirements set out in NI 21-101. Such requirements are substantive and, in our view, an impediment to international exchanges doing business in Canada. In addition, the AMF expects that such applicants would obtain a letter from the regulator in the home jurisdiction confirming that it complies with the requirements and conditions imposed and send such letter to the AMF. The AMF should not assume that foreign regulators will be willing to provide such letters on

a timely basis, if at all. [...]

We recommend that the AMF consider a system of mutual recognition for foreign-based exchanges and clearing houses which is not duplicative of such entities' compliance with their home jurisdictions laws and does not impose additional, burdensome requirements on such entities. [...]

In addition, the AMF should clarify when a foreign exchange or clearing house is conducting business or operating a market in Québec."

Our response to Kenneth G. Ottenbreit and Terence W. Doherty

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

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

Prospectuses

Comments from ISDA

"Instead of superimposing ill-suited prospectus [...] requirements and exemptions on the OTC derivatives market, the AMF should consider requiring only delivery of a customized disclosure document to a defined class of "retail customers" of OTC derivatives products. This retail disclosure document would be required to contain a clear, concise and simple description of the particular OTC derivatives product, the underlying instrument from which the product is derived and the particular risks inherent in each.

[...] Unlike prospectus-type disclosure, the document should not, however, have to be approved again in connection with each product or transaction, and should not give rise to any continuous disclosure obligations."

Comments from Desjardins Group

"To reduce costs and streamline the process, we recommend that providing [Desjardins caisse members] with an informative brochure, rather than filing a prospectus, would be sufficient."

Our response to ISDA and Desjardins Group

At the very least, investors should be provided an information document disclosing a product's features and explaining the risks involved in trading derivative instruments. Please also refer to our response in the section on "OTC markets".

Registration and registration exemptions

Comments from SG Canada

"SG Canada submits that any new regulatory regime for derivatives should provide a clear definition of when foreign intermediaries involved in "derivative" trades would be required to register in Quebec, and that the legislation should reflect a recognition mechanism by which regulation and supervision in a foreign jurisdiction would be sufficient basis for an exemption from the registration obligation in Quebec from registration. In addition, SG Canada submits that a clear exemption from registration be available for foreign intermediaries that deal solely with accredited investors."

Comments from Kenneth G. Ottenbreit and Terence W. Doherty

"We generally support the present registration regime which does not distinguish between dealers or advisers trading securities and those that trade derivatives. [...] It is our view that it is unnecessary to create a new category of registration for dealers or advisors to trade or advise on derivatives.

[...] We recommend that any new legislation or changes to existing legislation continue to permit international firms to trade in derivatives on an unregistered basis with "accredited investors. [...] We recommend that the AMF retain such exemption or broaden the exemption to accredited investors for advising with respect to derivatives. [...]

We recommend that the AMF consider issues raised by the Canadian Securities Administrators Registration Reform Project prior to any final recommendation regarding registration requirements for derivatives dealers and advisors in order to harmonize the registration regime across Canada for both domestic and international firms. The current regulatory framework in Canada applicable to non-Canadian dealers and advisers is extremely fragmented and inconsistent which only adds regulatory costs for such firms."

Comments from the FIA

"[...] the AMF should not impose a registration requirement on non-Canadian FCMs that trade only with "accredited investors" and should broaden the list of exempt clients for CTAs."

Our response

Duly noted. The CSA's proposed registration reform includes an in-depth study of these issues for the securities sector. We will assess the appropriateness of proposed new rules with respect to derivatives markets.

Comments from Desjardins Group

"Because derivatives are often included in or involved in financing transactions, banking services and financing officers should all be registered as derivatives dealers [...]."

Our response to Desjardins Group

We do not believe that registration is necessary in these circumstances.

Training/Proficiency

Comments from the CSI

"[...] here are the difficulties inherent in [...] this AMF recommendation:

- Requirements in terms of basic proficiencies are already very high. [...]
- Existing requirements for authorization to trade options confer a real proficiency. [...]
- Basic courses are already wide-ranging and cover topics in-depth. [...]
- The fact that several firms hesitate to trade options appears to be linked to the risk involved and increased regulatory supervision. Proficiency does not seem to be an issue."

Comments from the Institute of Canadian Bankers

"Our first concern pertains to the consequences of preserving the current proficiency model, under which the IDA has granted the Canadian Securities Institute (CSI Global Education Inc.) exclusive rights for the training and examinations necessary to be licensed in securities (including courses on options and futures)."

Comments from the CAC

"Moreover, we believe that the basic course necessary for registration as a retail investment representative must be upgraded to include the knowledge required for trading equity options, as is the case in the US. The less stringent Canadian requirements partly explain why the equity option market is underdeveloped in our country."

Our response

We have made a note of all your comments. The CSA's proposed registration

reform seeks to modernize training requirements by notably focusing on passing an examination rather than completing specific training courses.

We are sensitive to the difficulties arising from the addition of proficiencies to the topics already studied, but nonetheless believe that wider-ranging knowledge of derivative instruments in general and options in particular is critical to ensuring that quality services are available to investors.