



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

March 3, 2022

Alberta Securities Commission  
Autorité des marchés financiers  
British Columbia Securities Commission  
Financial and Consumer Services Commission (New Brunswick)  
Financial and Consumer Affairs Authority of Saskatchewan  
Manitoba Securities Commission  
Nova Scotia Securities Commission  
Nunavut Securities Office  
Ontario Securities Commission  
Office of the Superintendent of Securities, Newfoundland and Labrador  
Office of the Superintendent of Securities, Northwest Territories  
Office of the Yukon Superintendent of Securities  
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward  
Island

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Dear Sirs/Mesdames,

**Re: Pension Investment Association of Canada (“PIAC”) Comments on Proposed  
National Instrument 93-101 – Derivatives: Business Conduct**

The Pension Investment Association of Canada (PIAC) would like to thank the CSA for considering our comments on Proposed National Instrument 93-101 – *Derivatives: Business Conduct* (the “Proposed Regulations”) and accompanying Companion Policy.

PIAC has been the voice for Canadian pension funds since 1977 in matters related to pension investment and governance. PIAC’s members manage over \$2.2 trillion of assets on behalf of millions of Canadians. Our mission is to promote sound investment practices and good governance for the benefit of plan sponsors and beneficiaries.

PIAC is supportive of the CSA’s efforts to introduce business conduct regulations on derivatives dealers and derivatives advisers, including in respect of short-term FX transactions in the institutional FX market. PIAC would like to comment on the following aspects of the Proposed Regulations:

- PIAC is concerned with the inclusion of “Directly or indirectly carrying on the activity with repetition, regularity or continuity” and “Transacting with the intention of being compensated” as factors to be considered in determining whether a person or company meets the definition of “derivatives dealer” or “derivatives adviser”. These factors, as drafted, are overly broad and may inadvertently capture pension plans or their sponsors. We propose that the companion policy include further clarification to ensure that certain typical pension plan investment trading activities (with repetition) on their own will not be considered to be in the business of trading derivatives (acting as dealer) if facing a derivatives dealer, and that receiving option or derivative premiums will not be characterized as compensation.
- PIAC supports and is encouraged by the inclusion of Spot FX in the wholesale foreign exchange market within the scope of the Proposed Regulations.
- PIAC supports and appreciates the fair dealing requirements and the requirements to disclose conflicts of interest.

Detailed discussion of each comment follows below.

### **1) Derivatives Dealer and Adviser - carrying on the activity with repetition, regularity or continuity or transacting with the intention of being compensated**

PIAC is concerned with the inclusion within the Companion Policy of “Directly or indirectly carrying on the activity with repetition, regularity or continuity” and “Transacting with the intention of being compensated” as factors to be considered in determining whether a person or company meets the definition of “derivatives dealer” or “derivatives adviser”.

Trading with repetition, regularity or continuity: Pension plans, due to their size and mandate, might engage in various types of OTC derivatives transactions with repetition, regularity or continuity, however, such plans and their sponsors do not act as a dealer (or adviser) in any traditional sense. For example, pension plans due to their size (some PIAC members have over \$100 Billion in assets) and level of sophistication might find it more efficient to obtain their exposures to equities, government bonds or credit by way of over-

the-counter derivatives. These OTC derivative transactions might involve either obtaining broad market exposures, or alternatively, entering into swap transactions in order to obtain exposures to single name or baskets of specific securities (for instance, purchasing equities meeting certain portfolio specific metrics such as low volatility or certain dividend attributes). In addition, pension plans might enter into hedging transactions, for instance, against rising interest rates, or to hedge foreign currency exposures. Such FX hedging usually involves rolling multiple three-month (or shorter) duration FX forward transactions with repetition and continuity. In addition, if a pension plan follows a liability driven investment strategy, it is likely to enter into recurring interest rate hedging transactions. Such transactions have the potential to be entered into with repetition, regularly or continuously due to the need to roll positions, to swap names in/out, and the need to diversify transactions across multiple counterparties, while limiting the size of trades with any particular dealer counterparty.

We appreciate that the CSA might wish to include this factor so as to capture certain market participants who are clearly acting as dealers, for instance, certain foreign exchange dealers taking orders from the general public, but where their market making activities are less clear. We would argue that such dealers would clearly be involved in soliciting in relation to transactions. Accordingly, we propose that the Companion Policy make a clear distinction that a party (or buy side participant party) will not be deemed to be in the business of trading in derivatives (acting as derivatives dealer) if the only applicable factor is that they are carrying out the derivative trading activity with repetition, regularity or continuity and where they are facing a dealer in those trades.

Transacting with the intention of being compensated: Pension plans, due to their size and mandate, might engage in various types of OTC derivatives transactions resulting in their earning various forms of compensation in the form of P&L including receiving premium payments, however, such plans and their sponsors do not act as a dealer (or adviser) in any traditional sense. We appreciate that the Companion Policy has indicated that a “person would not be considered to be a derivatives dealer solely by reason that it realizes a profit from the changes in the market price for the derivative (or its underlying reference asset), regardless of whether the derivative is intended for the purpose of hedging or speculating.” However, we believe that the Companion Policy needs to be more prescriptive, and specifically exclude premium payments on derivatives transactions received by persons as being considered compensation for carrying on transaction activity.

By way of an example, pension plans might not always be exclusively long only. Instead, as part of a strategy, the pension plan might sell options or enter into credit derivatives, where they would receive premium payments paid by the dealer. Such premium payments are intended to compensate the option writer for the risk that the security becomes in-the-money to the dealer option buyer counterparty (resulting in the pension plan being required to make a payment). We are of the view that the fact that a pension plan might receive premium payment compensation is not the type of compensation that one would associate with acting as a dealer. Instead, we would expect dealers to be compensated by way of spreads or built-in fees. Essentially, if a pension plan will be exposed to losses due to certain market corrections, then that does not constitute market making activities. Instead, the market maker in that example would be the dealer that is sitting in between the ultimate option buyer and ultimate option seller, or credit protection buyer and credit protection seller

(the party prepared to become exposed to certain market risks due to their view of the market, and the party seeking to hedge against such market risks). The dealer in that instance is the party that is earning spreads for entering into both sides of that transaction (facilitating or intermediating the transaction) and is otherwise engaged in market making activities.

Respectfully, the use of OTC derivatives by pension plans should not be indicative of the activities of a dealer, regardless of trading frequency or potential for compensation. Instead, we believe that the other factors articulated by the CSA in the Companion Policy to the Proposed Regulations, including acting as market maker, intermediating transactions, solicitation of trades and providing derivatives clearing services, are the hallmarks of what are generally regarded as dealer or adviser activities. We are concerned that the inclusion of the factors "Directly or indirectly carrying on derivatives trading activity with repetition, regularity or continuity" and "Transacting with the intention of being compensated" has the potential to capture pension plans and their sponsors. In our view, frequent derivatives trading activity, whether or not any compensation (as broadly described in the Companion Policy) is received, in the absence of the other business purpose factors, should not constitute dealing or advising activities.

Accordingly, we propose that the CSA incorporate two clarifications into the Companion Policy (i) a party will not be viewed to be in the business of trading in derivatives (acting as derivatives dealer) if the only applicable factor is that they are carrying out the derivative trading activity with repetition, regularity or continuity and where they are facing a dealer in those trades, and (ii) that receiving option or derivative premiums will not be viewed as "transacting with the intention of being compensated".

## **2) Short-term FX transactions in the institutional foreign exchange market**

PIAC supports and is encouraged by the inclusion of certain short-term foreign exchange contracts or instruments in the wholesale foreign exchange market (Spot FX) within the scope of the Proposed Regulations. We take comfort from the introduction of certain regulations (in particular related to fair dealing, conflicts of interest and complaints handling) for Spot FX between PIAC members and large Canadian financial institutions. While we would like to hope that such regulations would not be necessary, we are happy that regulations will apply to Spot FX. The Companion Policy had referenced certain malfeasance in the FX derivatives markets by Canadian financial institutions, with breaches of client confidentiality (or worse) involving certain Canadian banks. While manipulation of markets or breach of confidentiality is less of a risk involving Spot FX (especially involving major deliverable currencies) we believe there is value to provide Canadian regulators with the necessary tools in the event that there is a misconduct issue. For instance, it might be a fair dealing issue should a PIAC member enter into a spot FX transaction that clearly has the pricing on currency pairs reversed (for instance, a plan converting back from GBP to CAD, and quoted based on the CAD to GBP rate). While our Canadian banking providers would typically quickly remedy any such clear error, it is helpful to have fair dealing and a complaints handling process for Spot FX. Finally, we would emphasize that while we appreciate that the large Canadian financial institutions (having over 500BN notional of derivatives) have adhered to the FX Global Code of Conduct, which Code promotes

stronger governance, transparency and fairness standards in dealing in the FX markets, the FX Global Code of Conduct is very clear that it does not impose legal or regulatory obligations on market participants. Integrating code of conduct into regulations is therefore helpful.

### **3) Fair Dealing & Disclosure of Conflicts of Interest**

PIAC supports the fair dealing requirements within Section 8 of the Proposed Regulations and the concept that a derivatives firm or individual acting on behalf of the firm must deal fairly, honestly, and in good faith with a derivatives party. In addition, PIAC supports the requirements to disclose conflicts of interest. PIAC had previously provided our comments on these two issues within our August 29, 2017 comment paper on 93-101. We appreciate that the CSA has considered our comments, and we are happy with the currently proposed language and approach for these requirements.

### **Four PIAC Areas of Focus**

We would like to thank the CSA for considering the comments from PIAC on the Proposed Regulations and accompanying Companion Policy.

In summary, PIAC believes that: (1) the Companion Policy should clarify that a party will not be viewed to be in the business of trading in derivatives (acting as derivatives dealer) if the only applicable factor is that they are carrying out the derivative trading activity with repetition, regularity or continuity and where they are facing a dealer in those trades; (2) the Companion Policy should clarify that receiving option or derivative premiums will not be viewed as “transacting with the intention of being compensated”; (3) certain short-term foreign exchange contracts or instruments in the wholesale foreign exchange market should be included within the scope of the Proposed Regulations; and (4) the CSA has done a commendable job in addressing fair dealing and conflict of interest requirements.

We trust our response has been helpful. Thank you for your attention and please do not hesitate to contact us if you have any questions or concerns.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sean Hewitt', with a stylized flourish at the end.

Sean Hewitt  
Chair