



**BY COURIER AND EMAIL**

August 25, 2006

**Ontario Commodity Futures Act  
Advisory Committee**  
c/o Davies Ward Phillips & Vineberg LLP  
Suite 4400, 1 First Canadian Place  
Toronto, Ontario M5X 1B1

**Attention: Ms. Carol Pennycook, Chair**

Dear Sirs/Mesdames:

**Re: Review of Ontario's Commodity Futures Act**

The Futures Industry Association (“FIA”) is pleased to provide this comment letter to the Ontario Commodity Futures Act Advisory Committee (the “Committee”) with respect to the Committee’s Interim Report to Minister Gerry Phillips, Minister of Government Services and Minister responsible for securities regulation dated May 25, 2006 (“Report”).

The FIA is a principal spokesman for the commodity futures and options industry. Our regular membership is comprised of approximately 40 of the largest futures commission merchants (“FCMs”) in the United States. Among our approximately 150 associate members are representatives of virtually all other segments of the futures industry, both national and international, including US and international exchanges, banks, legal and accounting firms, introducing brokers, commodity trading advisors (“CTAs”), commodity pool operators and other market participants, and information and equipment providers.

The FIA supports the initiative of the Committee to address the regulation of derivatives and futures in Ontario as regulatory certainty in the derivatives and futures markets is crucial to the efficient operation of these markets in Ontario for both domestic and international industry participants.

In our view, the goals of such a regulatory initiative should include:

- to provide institutional investors with rational access to international products and markets, including through reasonable registration exemptions for non-Canadian FCMs and CTAs;
- to provide more trading opportunities for customers;
- to facilitate innovative electronic trading techniques;

- to promote competition among exchanges world-wide; and
- to foster international regulatory cooperation.

The FIA comments relate primarily to the regulation of non-Canadian FCMs and CTAs and exemptions from such requirements, and the regulation of non-Canadian exchanges and the accessibility of non-Canadian exchange-traded futures and options for Ontario investors.

For the reasons set forth below, the FIA submits that:

- (a) there should not be a registration requirement on non-Canadian FCMs that trade with or CTAs that advise “accredited investors”;
- (b) Ontario 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 Ontario;
- (c) as a general matter, a “core principles” approach to regulation is the preferred approach, especially relating to the self-certification of new products; and
- (d) the Committee’s recommended approach to defining derivatives (i.e., a generic definition restricted to exchange traded contracts and products) is appropriate.

## **REGISTRATION REQUIREMENTS FOR DEALERS AND ADVISERS**

In the Report, the Committee requested comments on how intermediaries should be regulated.

The FIA strongly urges the Committee to recommend an approach that would permit non-Canadian FCMs to trade futures and options with institutional investors on an exempt basis. FIA recommends that non-Canadian FCMs and CTAs be exempt from the requirement to register as dealers or advisers in Ontario if such FCMs and CTAs limit their activities to trading with or advising “accredited investors” as defined in National Instrument 45-106 – *Prospectus and Registration Exemptions* (“**NI 45-106**”). The FIA believes that the legal exemptions should be based on the type of person that trades or is advised on such products rather than the products themselves.

The FIA understands that Canadian-resident persons or companies desiring to trade or advise in Ontario with respect to commodity futures are presently required to comply with licensing, proficiency and compliance requirements of the Investment Dealers Association of Canada (“**IDA**”) and the Ontario Securities Commission (“**OSC**”).

The FIA understands that under the current regulatory regime in Ontario, non-Canadian FCMs and CTAs are required to register as dealers or advisers in Ontario under the Commodity Futures Act (“**CFA**”) if dealing or advising with respect to commodity futures, or under the Ontario Securities Act (the “**OSA**”) if dealing or advising with respect to securities, unless they obtain an exemption from such requirements. The FIA understands that the CFA currently provides limited statutory exemptions from the registration requirement for trades in a contract by a “hedger” through a dealer and unsolicited trades in contracts on exchanges situated outside

Ontario. However, the practical effect of the current rules is that there is no method for non-Canadian FCMs dealing in commodity futures under the CFA to register in Ontario without establishing an office in Ontario.

The FIA encourages the Committee to recommend exemptions for trading with or advising institutional investors in Ontario without requiring dealers and advisers to register or file documentation with the OSC. It is the FIA's view that such filings are not necessary to protect investors in the institutional market and present an unnecessary additional layer of administrative requirements.

Furthermore, the FIA supports the harmonization of 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 the inconsistent provincial requirements add to the regulatory burdens and costs for international firms wishing to participate in the Ontario and Canadian markets.

## **REGULATION OF FOREIGN EXCHANGES**

In the Report, the Committee requested comments on the regulation of exchanges. The FIA notes that the Committee recommends that foreign-based exchanges be regulated under the new legislation by requiring exchanges that carry on business in Ontario to be recognized or exempt from recognition by the OSC.

However, the FIA also notes that, in connection with the Committee's consideration of the appropriate regulation of alternative trading systems with respect to derivatives, OSC staff has recommended a concept of marketplaces similar to that in National Instrument 21-101 – *Marketplace Operation* (“**NI 21-101**”). Pursuant to NI 21-101 the OSC requires foreign-based exchanges to file an application (made on Form 21-101A1) in accordance with the requirements set out in NI 21-101. Such requirements are substantive and, in the FIA's view, an impediment to non-Canadian exchanges doing business in Ontario. The FIA believes that 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 OSC would provide additional investor protection.

Furthermore, the FIA notes that OSC Staff also supports a core principles approach to the regulation of exchanges, and that OSC staff has recommended an approach similar to that described in OSC Staff Notice 21-702 “*Regulatory Approach to Foreign Based Stock Exchanges*” (“**21-702**”) with respect to securities exchanges. The FIA notes that 21-702 proposes that foreign-based stock exchanges be recognized or exempted from recognition, and at the time of application for recognition or exemption from recognition the foreign-based stock exchange must establish it meets criteria substantially the same as a resident Canadian exchange would be required to meet pursuant to NI 21-101. Such criteria includes information about corporate governance structure, details about access, rules and rulemaking, systems and technology, financial viability, clearing and settlement, among other details. The FIA believes that such recognition or exemption from recognition requirements are unnecessary as such exchanges are regulated in their home jurisdiction.

The FIA notes that the Committee recommends that the proposed new derivatives legislation should provide guidance on what it means to carry on business in Ontario. In particular, the FIA urges the OSC to make clear in the proposed new derivatives legislation that the fact that derivatives contracts listed on a non-Canadian exchange may be sold in Ontario to Ontario residents through Canadian dealers or advisers that are subject to registration and oversight in Ontario, or through FCMs and CTAs that are otherwise exempt from the registration requirement, does not result in the conclusion that the non-Canadian exchange itself is carrying on business in Ontario which would require it to be recognized or registered. Furthermore, the FIA submits that the OSC should also make clear that futures and options products that trade on a non-Canadian exchange are not required to be reviewed, accepted or approved by the OSC prior to their trading in Ontario.

We encourage the Committee to review the regulation of non-Canadian exchanges in light of changes in the electronic trading landscape. In particular, we would encourage the Committee to review concepts such as “carrying on business in Ontario” and “jurisdiction” with a view to the reality of today’s electronic marketplaces. Historically, under U.S. rules, an exchange’s location was determined by looking at the location of the exchange’s trading floor as well as where it was legally-organized, its self-regulation was conducted or managed and its government regulation was authorized. As electronic trading systems have largely supplanted trading floors worldwide, linking an exchange’s location to where its orders are matched is now more of a challenge. However, many international (non-Canadian) exchanges are legally organized and incorporated outside of Canada, are managed by self-regulators outside of Canada and are subject to meaningful government regulatory regimes outside of Canada. In these circumstances, FIA believes these exchanges should not be regulated by the OSC in addition to the home jurisdiction so long as customers trade on these markets through, or as authorized by, regulated or exempt intermediaries.

Consistent with this view, the FIA believes that the OSC should recognize home country regulation and not regulate based on factors such as Canadian customer volume, exchange server placement, or the “nationalizing” of particular futures contracts. Each of these factors could disadvantage Canadian customers, decrease exchange competition and add substantial costs. FIA submits that it is not necessary for the OSC to separately regulate non-Canadian exchanges that are regulated by foreign regulators, even if such regulations differ from those of the OSC.

The FIA notes that in British Columbia, Alberta, Saskatchewan and certain other provinces, foreign exchanges and clearing houses are recognized by order or other document without the need to provide, for example, financial statements, rules and contract specifications. Such entities are granted recognition based upon the regulatory approval status in their home jurisdictions. The FIA believes that it is unnecessary for the OSC to conduct an extensive and prolonged review of such entities as they are regulated in their home jurisdiction. We urge the OSC to recognize such entities as a matter of course based upon standing in their home jurisdiction. It is our understanding that no foreign-based exchange has applied under NI 21-101 for approval as an exchange in Canada to date although ICE Futures has applied to the OSC for an exemption from recognition as a stock exchange and registration as a commodity futures exchange and such application has become the subject of a “Notice and Request for Comments – ICE Futures’ Application for Exemption from Recognition and Registration as an Exchange” – (2006) 29 OSCB – July 21, 2006.

In addition, the OSC should clarify when a foreign exchange or clearing house is conducting business or operating a market in Ontario. Such entities are confronted with regulatory uncertainty in Ontario because there is no clear guidance as to when they are subject to regulation.

### **“CORE PRINCIPLES” REGULATORY APPROACH**

As a general matter, the FIA supports a regulatory approach based on “core principles”, especially with respect to the self-certification of new products. The FIA understands that the principles-based regulation is becoming increasingly accepted by regulators and market growth and innovation by market participants require a regulatory process that is able to keep pace with these changes.

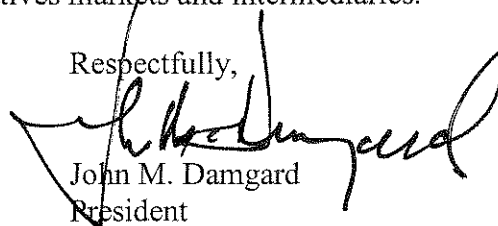
It is the FIA’s view that regulatory principles should be framed so as to be adaptable to the evolution of the markets and such flexibility is needed to allow for innovation without the delays inherent in regulatory amendments.

### **DEFINITION OF “DERIVATIVES”**

The FIA supports the Committee’s recommended approach to defining “derivatives” (i.e., a generic definition restricted to exchange traded contracts and products). The FIA agrees that the definition should not be an “extended” or “all-inclusive” definition so as to avoid regulatory overlap and uncertainty and cover only those products and investors that the OSC intends to regulate under any new derivatives legislation. Furthermore, the recommended approach will provide flexibility from a regulatory standpoint and will facilitate the introduction of new products and would be generally consistent with a core principles approach.

Should you have any questions or comments, do not hesitate to contact the FIA. The Executive Committee of our Law and Compliance Division would be pleased to work with you as you continue to address the regulation of derivatives markets and intermediaries.

Respectfully,



John M. Damgard  
President