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SUBMITTED ELECTRONICALLY

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Autorité des marchés financiers  
British Columbia Securities Commission  
Manitoba Securities Commission  
New Brunswick Securities Commission  
Ontario Securities Commission  
Saskatchewan Financial Services Commission

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**Re: Canadian Securities Administrators (“CSA”) Consultation Paper 91-406 on Derivatives: OTC Central Counterparty Clearing, CSA Derivatives Committee June 20, 2012 (the “Committee”)**

Dear Mr. Stevenson and Me Beaudoin:

TMX Group Ltd. (“TMX Group”) appreciates the opportunity to comment on the CSA Consultation Paper 91-406 on Derivatives: OTC Central Counterparty Clearing (the “Consultation Paper”). The Consultation Paper invited market participants to provide

input on Committee proposals regarding requirements for CCP clearing of previously bilaterally cleared or uncleared derivatives transactions.

The form and implementation of CCP clearing requirements will have a significant impact on the effectiveness of these measures in mitigating both firm and systemic risk, and we commend the Committee and the CSA for addressing the regulatory objectives, key issues and challenges associated with this reform in a thoughtful and consultative manner.

The implementation of CCP clearing requirements for OTC derivatives will also have a significant impact on Canadian derivatives market participants and intermediaries, as well as on TMX Group subsidiaries, and our domestic and foreign market participants. There are three CCPs in TMX Group – CDCC, NGX and CDS – and this gives us a unique set of skills, expertise and perspectives on clearing issues in the Canadian marketplace. Although many of our comments on OTC Central Counterparty Clearing are addressed in broad terms, we would be pleased to expand on our comments, either in writing or in person.

### **TMX Group**

TMX Group's key subsidiaries operate cash and derivative markets for multiple asset classes including equities, fixed income and energy. Toronto Stock Exchange, TSX Venture Exchange, TMX Select, Alpha Exchange, The Canadian Depository for Securities, Montréal Exchange, Canadian Derivatives Clearing Corporation, Natural Gas Exchange, Boston Options Exchange, Shorcan, Shorcan Energy Brokers, Equicom and other TMX Group companies provide listing markets, trading markets, clearing facilities, data products and other services to the global financial community. TMX Group is headquartered in Toronto and operates offices across Canada (Montreal, Calgary and Vancouver), in key U.S. markets (New York, Houston, Boston and Chicago) as well as in London, Beijing and Sydney.

### **Mandatory Clearing Requirements**

We strongly agree with the Committee that CCP clearing of OTC derivatives will deliver significant benefits in terms of greater transparency and risk mitigation, and we agree with the Committee's recommendation to implement a mandatory requirement for the centralized clearing of OTC derivatives.

As we indicated in our comment letter on CSA Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada, we believe that CCP clearing offers both firm level benefits, including capital, collateral and operational efficiencies, and the systemic level benefits, including systemic risk mitigation, that will greatly improve the resilience of the Canadian financial system and improve the overall efficiency of these markets.

### **Derivatives Subject to a Mandatory Clearing Requirement**

The TMX Group agrees with the Committee's recommendation to implement both bottom-up and top-down approaches for determining whether an OTC derivative is eligible for mandatory CCP clearing. It is also very important that the rules for determining eligibility incorporate to the extent appropriate international best practices,



including those being developed by the US CFTC and ESMA, in order to minimize the risk of regulatory arbitrage.

With respect to the top-down approach, the Committee states that “Market regulators may determine that a derivative is sufficiently standardized and meets the regulatory requirements for CCP clearing; however the determination to clear the derivative or not should ultimately be made by the CCP, based on its risk analysis (and not for anti-competitive reasons).” While we believe that the top-down model complements the bottom-up model, we believe that CCP risk analysis is not the only factor that a CCP must consider when considering whether to clear a derivative. We respectfully submit that in addition to the risk analysis conducted by the CCP the cost to the CCP and its members of clearing the derivative is a valid consideration. A CCP and/or its clearing members may validly determine that it cannot justify the costs of setting up and operating clearing infrastructure and processes for a particular derivative given the expected volume of transactions and the potential revenue stream. This cost factor is independent of any anti-competitive reasons, and should be recognized by the Committee as an important and legitimate factor for a CCP to take into consideration when determining whether it will accept a derivative for CCP clearing.

Other factors to consider when determining eligibility for CCP clearing include size and maturity of market as well as the physical delivery component of the subject asset class.

With respect to size and maturity of market, developing markets in any particular asset class are less suited for CCP clearing. In addition to the CCP risks of clearing illiquid markets, the additional capital requirements and costs (clearing costs, internal resource requirements etc.) may outweigh the benefits resulting in a decrease in market participants and diminished activity. Clearing costs generally decrease in relation to the liquidity of the market as greater liquidity allows for greater offsets and capital efficiencies. New and smaller markets need time to evolve, and mandating CCP clearing prior to adequate market maturity may hinder the development of such markets.

When considering the eligibility for CCP clearing, we recommend that regulators also assess the portion of transactions that result in physical delivery of the underlying commodity. While the CFTC largely relies on the “intent to deliver” test in determining eligibility as an exempt (forward) product, this concept is difficult to measure and somewhat subjective in nature. We would encourage the development of bright line tests which exempt certain markets from CCP clearing if the portion of physical deliveries of a particular asset class meets or exceed specified thresholds.

### **Clearing Timeframes**

While we do not believe that deferred submission engenders significant counterparty or other risks provided that the transaction is properly collateralized and risk management controls are in place at the time of novation to the CCP, shorter times between execution and confirmed acceptance of a transaction by the CCP lowers the overall risk to the marketplace.

End-users generally enter into new transactions on the premise that previously transacted volumes will be confirmed. Accordingly, from a portfolio basis, it is very important that all executed transactions are crystallized as soon as possible in order to ensure the desired market position is achieved. Any uncertainty of crystallization, for



example an uncertainty in CCP acceptance of a trade, could dampen market liquidity as participants delay further activity awaiting final confirmation. The greater the timeframe from point of execution to confirmation the greater the risk of adverse price movement. While this price movement can be managed by the CCP through additional collateral, there is an increased risk that the trading entity(s) does not have sufficient margin capacity to clear the transaction possibly resulting in the unwinding of the transaction.

Accordingly, we agree with the Committee's recommendation that there should be clear timeframes requiring prompt reporting of derivatives transactions and the prompt review and acceptance or rejection of the transaction by the CCP. These timeframes should strike the appropriate balance between risk management requirements and the operational capacity of Canadian market participants,

### **Intragroup Transactions**

The TMX Group agrees with the Committee that certain intra-group transactions should be exempted from mandatory CCP clearing requirements. We respectfully submit that further clarification is required as to the framework for determining these exemptions.

For example, a change in risk exposure to third parties should be considered a factor that mitigates against an exemption from mandatory CCP clearing. In the first example provided in the consultation document, the transaction is between two related entities that have access to the same capital within one of the entities or a parent. The transactions net each other out and there is no additional implicit risk generated by the transaction. This transaction would therefore be a candidate for an exemption.

However, in the case where the two related entities are separately capitalized such that the transaction will result in a change in the risk exposure that either entity has to third-parties, we do not believe that the transaction should be exempt from a clearing requirement. The Committee has properly identified the effective management of counterparty credit risk as one of the key drivers behind CCP clearing for OTC derivatives. An intra-group transaction resulting in a change in risk exposure for a third party would therefore be a very appropriate candidate for CCP clearing, and should not be exempted

### **Recognition of Central Counterparties**

The TMX Group supports the Committee's recommendation of the recognition and regulation of CCPs by market regulators, including the requirement that in order to be recognized a CCP must comply with FMI Principles as set out by CPSS and IOSCO.

CCPs play a pivotal role in the financial system. Their role in the management and in many cases the mutualisation of risk also results in an inevitable concentration of risk in the CCP. Robust, properly managed and well-regulated CCPs are therefore critical to financial stability. In order for Canada to fulfill its G20 Commitments we view it as essential that Canadian regulators ensure the recognition, regulation and oversight of all CCPs, including compliance with the FMI Principles. We also strongly support the Committee's recommendation that this requirement apply to all CCPs offering clearing services to a person carrying on business or resident in Canada, especially given the international nature of OTC derivatives markets and the proportion of cross border OTC transactions conducted by Canadian counterparties. With regards to the particularly

sensitive role played by CCPs, we advocate a recognition requirement as a stronger guarantee of sound governance, management and regulatory oversight than an exemption regime.

## **Governance**

The TMX Group agrees that relevant stakeholders should have input into the operational decisions of a CCP operating in Canada. This recommendation is consistent with the CPSS-IOSCO Principles for financial market infrastructure. Given the loss-sharing mechanism implicit in mutualised and intermediated CCP clearing, clearing members of the CCP should clearly be included in this group of relevant stakeholders.

## **Advisory Committees**

The TMX Group supports the recommendation that CCPs operating in Canada should establish advisory committees to allow stakeholders to provide input into certain operational decisions.

## **Participant Access**

The TMX Group supports the principle of objective, risk-based and transparent access rules for potential clearing members. The financial soundness and capitalization of clearing members is one of the most important risk management factors in a mutualized risk model. Access criteria for clearing members must reflect the specific risks of the CCP and the market that it serves, and the TMX Group believes that the CCP is in the best position to establish these minimum capital requirements.

## **Open Access to Trading Platforms**

The TMX Group believes that the highly fragmented nature of OTC market liquidity necessitates that CCPs provide access to multiple OTC trading and execution venues.

OTC derivatives are traded bilaterally as well as on multiple execution platforms. In order to capture these trades and maximize the benefits of CCP clearing, CCPs must allow access from multiple venues and platforms. The CCP must rely on its default auction process to liquidate a defaulter's book in these markets, and the concentration of trades in a deep and liquid central limit order book is not as essential to default management as in exchange-traded derivatives markets.

Our comments with respect to access are limited to OTC derivatives. We believe that in the case of standardized exchange-traded derivatives the deep and liquid markets resulting from a vertically integrated trading and clearing structure can assist the CCP in managing risk in the case of a clearing member default in the market itself, and therefore can significantly mitigate the risk to the clearing fund.

## **Reporting**

We believe that there are two broad categories of information that the CCP should provide and that should be made publicly available: costs and risk.



With reference to costs, information should be provided with respect to costs of access, connectivity, transactions and the margining model, so that the participants can ascertain the cost of funding collateral.

With reference to risk, in particular credit risk, a CCP should provide information with respect to membership requirements and membership lists, margining models, the default waterfall structure, and actual stress test results on a confidential basis so that each firm can quantify its contingent liability to the clearing fund.

### **Foreign-based CCPs and Regulatory Cooperation**

The TMX Group supports the Committee's efforts to follow international recommendations in the development of Canadian policy and regulation. International cooperation in the development and implementation of regulatory standards and principles is essential to establishing a fair and level playing field across all jurisdictions and reducing the risk of regulatory arbitrage. We also strongly support the Committee's participation in international regulatory forums to work towards the adoption by all regulators of high standards of regulation and supervision in implementing these recommendations.

Without minimizing the importance of international cooperation and common standards, we wish to reiterate that it is important that Canadian regulators retain the sole responsibility and authority for the recognition, regulation and oversight of all CCPs operating in Canada, including compliance with the FMI Principles. The systemic risk mitigation role of Canadian regulators is essential to the stability and security of the Canadian economy, and it is therefore important that exchanges and CCPs be well-regulated, recognized and under the regulatory supervision of Canadian authorities. In our view this is the best way of assuring that risk management and operations are conducted according to the appropriate standards, and that authorities have an unobstructed view into the operations of the CCP and the positions and exposures of its members.

### **Other Proposed Changes to the Canadian Legal and Regulatory Framework**

#### **Portability and Segregation of Collateral**

As we indicated in our comment letter on "Consultation Paper 91-404 on Derivatives: Segregation and Portability in OTC Derivatives Clearing," ("Consultation Paper 91-404") a legal and regulatory framework must be developed to support the segregation and portability of customer positions and collateral. This framework should permit the co-existence of multiple segregation models under a unique CCP in order to effectively support both listed and OTC markets. The framework requires that bankruptcy and insolvency laws allow that Complete Legal Segregation for OTC derivatives and the omnibus model for futures contracts can co-exist within a single CCP without diminishing the protection afforded to segregated accounts.

#### **Cash Collateral Issues**

As discussed in the Committee's Consultation Paper 91-404, the uncertainty of CCP transferee/depository rights in cash collateral versus its members (transferors/depositors) rights is a significant issue that may present an obstacle to

efficient OTC derivatives clearing. The TMX Group therefore supports the adoption of a legal framework that will provide greater legal certainty and a higher degree of protection and priority for the respective rights of CCPs and their members in cash collateral.

#### CCP Interoperability

Finally, we recommend that a regulatory framework for CCP interoperability should be developed between Canadian and international regulators. Interoperability will ensure that smaller markets are able to develop CCP solutions that interoperate with larger global CCPs. This will support domestic clearing of derivatives under Canadian law and regulatory supervision, with full protection for Canadian market participants and end clients.

#### **CONCLUSION**

TMX Group is supportive of the general direction in which the CSA proposals have been framed. We applaud the commitment by the CSA to implement reforms intended to enhance the transparency of markets and the overall mitigation of risks. We believe that OTC markets will benefit from appropriate and sensible regulatory reform, and we are ready and willing to participate in the development and implementation of these reforms in order to improve market integrity and systemic stability.

Please feel free to contact me at (514) 871-3525 with any questions regarding our comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Alain Miquelon', with a long horizontal flourish extending to the right.

Alain Miquelon