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February 4, 2013

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RE: **Canadian Securities Administrators Staff Consultation Paper 91-301: Model Provincial Derivatives Rules**

Dear Sir or Madam

State Street Global Advisors Ltd. ("SSgA Ltd.") welcomes the opportunity to comment on Canadian Securities Administrators Consultation Paper 91-301 regarding the Model Provincial Rules which establish (i) the designation and operation of trade repositories and mandatory reporting of derivatives ("TR Rule"); and (ii) the determination of which products and financial contracts or arrangements are within the scope of the trade repository and reporting requirements ("Scope Rule") (collectively, the "Model Rules").

SSgA Ltd. is a wholly owned subsidiary of State Street Corporation, established in Canada in 1991 with local investment, client service, and operations personnel. With offices in Toronto and Montreal, SSgA Ltd. is a recognized leader and ranks as a major investment manager in Canada. Our clients are located across the country and include corporations, public funds, foundations, endowments, life insurance companies and government agencies.

In conjunction with SSgA's other investment centers and sister companies worldwide, State Street Corporation provides clients with integrated solutions that combine investment management, transition management, trust, custody, recordkeeping and administrative services.

In its capacity as an investment advisor or trustee, SSgA Ltd. is one of the largest end users of foreign exchange products in Canada. In calendar year 2012, SSgA Ltd. executed over 20,000 separate foreign exchange transactions, with aggregate notional exposure to all currencies equal to CAD 104 billion with 13 broker-dealers acting as market makers in the Canadian markets in various foreign exchange products.

Scope Rule

The Canadian Securities Administrators ("CSA") broadly defines a "derivative" as "an option, swap, futures contract, forward contract or other financial or commodity contract or instrument whose market price, value, delivery obligations, payment obligations or settlement obligations are derived from, referenced to or based on an underlying interest (including a value, price, rate, variable, index, event, probability or thing)." Further, the CSA has proposed certain transactions, contracts or financial arrangements that are not to be included in the definition of a derivative for the purposes of determining whether trade reporting obligations apply ("Excluded Products").

We generally agree with the proposed list of Excluded Products, which we assume is not exhaustive. However, we would request the CSA clarify that the list of Excluded Products includes (1) two additional transaction types; and (2) additional transactions related to an already Excluded Product. As we will explain below, we believe the list of Excluded Products could be expanded in this manner without any diminution of the goals that the CSA is attempting to achieve under the Model Rules.

1.1 Exclusion of "repos"

We would suggest that repurchase transactions or reverse repurchase transaction (collectively, "repos") should be explicitly excluded from the definition of derivatives. A repo is a transaction where a "buyer" agrees to purchase securities from a "seller" and there is a corresponding obligation for the original seller to repurchase the securities on an agreed date and at an agreed price, which generally is greater than the original purchase price. Although the transaction is treated as a "true sale" it is structured liked a secured loan, with the purchased securities acting as collateral and the additional amount in the repurchase price acting as interest. Repos are often documented under industry standard contracts such as the SIFMA Master Repurchase Agreement (for US securities) or the Global Master Repurchase Agreement (for non-US securities).

We are concerned these types of transactions would be included in the definition of derivative because they could be construed as a "financial ... contract or instrument whose market price, value, delivery obligations, payment obligations or settlement obligations are derived from, referenced to or based on an underlying interest". However, these transactions do not present the same investment or settlement risks inherent in swaps or derivatives. Some of the mitigating factors are that (i) these transactions are collateralized 100% of the amount due at repayment; (ii) exchanges occur on a "delivery vs. payment" basis; (iii) for repos done in the US, the trade settlement process is consolidated within two

large settlement banks that provide enhanced netting capabilities (*i.e.* Bank of New York Mellon and JPMorganChase) further mitigating settlement risks; and (iv) in the US repo markets are overseen by The New York Branch of the Federal Reserve Bank who play a role in ensuring market "best practices[1]."

1.2 Exclusion of exchange traded funds

We would request that that the CSA affirmatively clarify that the definition of derivatives excludes Exchange Traded Funds ("ETFs") including those benchmarked to a reference currency. ETFs are pooled investment vehicles which resemble registered mutual funds in many ways (*e.g.* centralized management; diverse unaffiliated beneficial owners; existence of daily NAV). They usually are passively managed and usually benchmarked to an index, or are structured to replicate the performance of a single currency, often achieved by having physical holdings of the currency ("currency ETF"). In this way the currency ETF creates an opportunity for retail investors to gain exposure to the currency markets. However, a key distinction is that ETFs, although often registered, for example, under the Investment Company Act of 1940, generally trade on a securities exchange and are also registered as "securities" on their relevant exchange.

The CSA has stated "All other contracts or instruments falling under both the OSA definitions of "derivative" and "security" are prescribed not to be derivatives." ETFs are a "security" under OSC rules.[2] ETFs, especially currency ETFs, most likely would be in the definition of derivative as the value of an ETF share is directly related to the exchange rates of the reference, benchmark currency. Therefore, per CSA sanctioned exclusion, it would seem currency ETFs would not be treated as derivatives. As the CSA has provided a list of Excluded Products, but has not included ETFs, we would ask that the CSA provide clear guidance on the treatment of ETFs and currency ETFs with respect to their treatment (or non-treatment) as derivatives.

2. Exclusion of certain FX transactions

We would request, for the reasons set forth below, that the definition of derivatives should exclude, in addition to FX spot transactions, FX deliverable forward transactions and FX non-deliverable forward transactions ("NDFs"). We would point out that this additional proposed exclusion of FX deliverable forward transactions would be consistent with the exclusion from the definition of "swap" as defined by the Commodity Futures Trading Commission ("CFTC") and The Treasury Department of the United States ("Treasury") under the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[3] for the purpose of central clearing requirements[4]. While U.S. Treasury's determination only covers deliverable forwards, and not non-deliverable forwards (NDFs),

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[1] *See e.g.* http://www.newyorkfed.org/tripartyrepo/

[2] Under OSC rules "security" includes, "...(h) any certificate of share or interest in a trust, estate or association..."

[3] 124 STAT. 1376; Pub L. 111-203

[4] 77 Fed Reg. 69694 - Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act; 77 Fed Reg. 48208 - Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping

we note that there is little economic difference between such transactions, and urge the CSA to provide an exception for both deliverable and non-deliverable FX forward transactions.

2.1 Exclusion of FX deliverable forward transactions

The reason for the requested exclusion of FX deliverable forward transactions from the definition of derivatives is that they, like repos, do not present the same credit risks, investment risks, or settlement risks inherent in swaps or derivatives. The description of the mitigating factors inherent in the product structures and market for these transactions was considered and detailed at great length by the aforementioned US regulators.[5] However, we would like to take the opportunity to highlight some of these reasons in support of our continued position that FX deliverable forwards should be excluded from material portions of the Model Rules. To wit, unlike derivatives;

- FX deliverable forwards involve the actual exchange of the principal amounts of the two currencies in the contract, unlike derivatives where the payment obligations fluctuate from time to time and are unknown until the actual final settlement or payment date.

- FX deliverable forwards require each party to the transaction to make a payment or delivery and this is usually done on a delivery vs. payment basis. Further, there is existing infrastructure in place in the marketplace for centralized settlement within CLS Bank. Originally created as Continuous Linked Settlement and operational since 2002, CLS is an "Edge Act Corporation", a limited purpose bank regulated by the Federal Reserve Bank of New York which provides centralized settlement for seventeen major currencies.

- FX deliverable forwards generally have a much shorter tenor than derivatives. FX deliverable forwards typically settle within months of the transaction inception and almost always settle in less than one year.

- FX deliverable forwards already trade in a highly transparent and liquid market where pricing trends and currency volumes can be readily obtained from independent publicly available sources.

- FX deliverable forward transactions are most often used as a risk management tool to hedge the currency risk of underlying investment and are not used for speculative purposes. Unlike derivatives, the use of these products actually minimizes financial risks inherent in cross-border investing. Once concern that end-users have raised is that burdensome regulations (such as required central clearing or reporting) may actually act as a disincentive to using these transaction and in fact increase systemic risks.

2.2 Exclusion of FX non-deliverable forward transactions

We also request that the CSA exclude FX *non*-deliverable forward transactions or "NDFs" from the definition of derivatives. An NDF is a cash-settled, forward contract on foreign currency that is most often subject to local currency restrictions preventing its actually

[5] *Ibid.*

delivery, where the profit or loss at the time of the settlement date is calculated by taking the difference between initial agreed exchange rate for the notional amount of two currencies and the spot rate prevailing at the time of settlement. Some market participants and regulators have viewed the cash settled nature of an NDF as akin to the settlement of a "swap."

In our view, however, the economic and operational features of NDFs make them identical to FX deliverable forward transactions in terms of their risk profile. In fact, we would note that SSgA's position with respect to NDFs is consistent with the position taken by the Investment Company Institute,[6] an influential trade organization representing the interests of mutual fund "end users" and their fiduciary advisors. But for the physical exchange of two currencies, NDFs may have all of the same risk mitigating features associated with FX deliverable forward transactions - they tend to have a shorter tenor relative to swaps; the referenced currencies often are liquid; NDFs can be used for hedging; they can settle through CLS.

TR Rule

The CSA has proposed that "'derivatives data' for each transaction be reported to" designated trade repositories, or "DTR or, if there is no appropriate DTR, to the local securities regulator." CSA has also established further parameters around these reporting obligations. We would request that the CSA consider an exemption to this reporting requirement, for the reasons set forth below, and that the CSA clarify the obligations with respect to which party to a transaction is required to report to the trade repository.

First, we would point out that much of the derivative trading activity SSgA Ltd. conducts on behalf of its clients is done on a cross-border basis. Much of this trading occurs in the United States, both over-the-counter and through established securities and futures exchanges. Because of the size, liquidity and sophistication of the US markets, it is in the best interests of our clients that we have exposure to those markets.

When transacting in derivatives for client accounts in the US, such derivatives are subject to the applicable US regulations. We have previously highlighted that the US has proposed its own regulatory overhaul of the derivatives market under the Dodd-Frank Act. One of the areas of regulation under the Dodd-Frank Act is the requirement to report "swaps" to a swap data repository.[6] This includes swaps that are FX transactions.[7]

Because SSgA Ltd.'s clients are required to report swaps (including FX transactions) transacted with a US swap dealer to a US swap data repository, there would now be duplicative reporting obligations in Canada. In addition to the increased legal risk of inadvertent non-compliance, each reporting derivative party has increased operational burdens. In the event the data that is required to be reported under the two regulations is not uniform, a party has further operational burdens. These operational burdens have the effect of draining resources, especially cash, from management activities of an advisor as

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[6] *See* ICI Comment Letter to the Treasury, 6 June 2011, *Determination of Foreign Exchange Swaps and Foreign Exchange Forwards under the Commodity Exchange Act*

[6] *Supra* 3 at § 27

[7] *Supra* 4

new systems, infrastructure and additional staffing needs to be considered to ensure the ability to comply with these regulations. In this case, in the absence of regulatory relief there is now a disincentive for Canadian domiciled clients to trading in the US, which could have unintended economic consequences. First, our clients who choose not to invest in the US may be unable to find derivatives, whether for hedging or speculation, available in the Canadian markets. Second, the existing derivative markets may suffer illiquidity or price disruptions if a sizeable number of market participants withdraw from these markets. Finally, in the absence of relief, US investors may choose not to transact in derivatives in Canada because of the same duplication of regulation. As the US is the largest investor in Canada[8], this obviously could have a detrimental effect on market–makers in Canada.

Under the Dodd-Frank Act, the possible existence of such duplicative regulations has been recognized. Therefore the CFTC has proposed in some instances, that compliance with the reporting requirements in the US may be waived *if* a non-US transacting party is complying with a similar reporting obligation in their home jurisdiction. One reason for the CFTC considering this exemption is that it is contemplated there will in the future be increased coordination among regulatory bodies from all major jurisdictions in regulating derivative markets, including the exchange of reportable information.

We ask that the CSA consider a similar exemption from reporting for entities that have duplicative reporting obligations. Further, SSgA asks that the CSA allow a derivative trading party to decide which reporting regulation to comply with if they can demonstrate that there are either significant operational, legal or financial benefits in utilizing the reporting regime they have selected.

Also, the CSA has proposed that if one party to a derivatives trade is a derivatives dealer, that party has the obligation to perform the reporting function. However, if the derivatives dealer is not a "local counterparty" and fails to perform the reporting function, the other party to the derivative is responsible to perform the reporting obligation. Our concern with this requirement is twofold. First, as a non-derivative dealer we would expect to rely on our derivative dealer counterparty to perform the reporting function but we would not necessarily know if they failed to perform, and the obligations would now have shifted to us. Second, monitoring the derivative dealer who is not a "local counterparty", and potentially having subsequent responsibility for reporting, would create new operational burdens on us. This will divert resources that could otherwise be used for performing other investment related activities, and could ultimately increase management fees that will be charged to our clients. By way of contract, under the Dodd-Frank Act the swap dealer who transacts with a non-swap dealer is solely the entity responsible for any required reporting, and an end user, such as the accounts managed by SSgA, will have no potential reporting obligations.

For this reason we ask that the CSA consider removing the contingent reporting obligations of a non-derivative dealer end user of derivatives, so long as such end user has obtained written representations and warranties from its derivative dealer counterparty that: (i) it is aware of its reporting obligations: (ii) has necessary infrastructure in place to ensure it can perform such reporting obligations; and (iii) agrees to undertake and perform such reporting.

[8] http://www.state.gov/r/pa/ei/bgn/2089.htm

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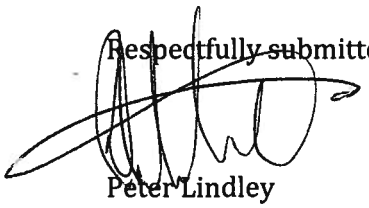
Thank you for the opportunity to provide comments and recommendations regarding the Model Rules.

Respectfully submitted,



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