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

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1900, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22^{e} étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs / Madames:

RE: CSA Consultation Paper 91-404 Derivatives: Segregation and Portability in OTC Derivatives Clearing

Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") regarding Consultation Paper 91-404 Derivatives: Segregation and Portability in OTC Derivatives Clearing ("CP 91-404") related to the segregation and transfer of assets put forward as collateral for Over-the-Counter ("OTC") derivatives transactions cleared by a central counterparty ("CCP").

Fidelity Investments Canada ULC ("Fidelity Canada") is a fund management company in Canada and part of the Fidelity Investments organization in Boston ("Fidelity Investments"), one of the world's largest financial services providers. Fidelity Canada manages a total of $67 billion in mutual funds and institutional assets (the "Funds"). It offers approximately 140 mutual funds and pooled funds to Canadian investors.

Fidelity Canada's use of OTC derivatives currently includes currency forwards to hedge currency risk in certain Funds, interest rate swaps for the purpose of managing fixed income portfolio duration, and customized forwards in certain funds managed by Fidelity Canada.

Fidelity Canada generally supports the views of the Canadian Securities Administrators Derivatives Committee (the "Committee") and the Committee's recommendations relative to ensuring that CCPs clearing OTC derivatives possess adequate rules and infrastructure to facilitate the segregation and portability of collateral in a manner that appropriately protects market participants.

Fidelity Canada's responses to the questions in CP 91-404 are noted below:

Question 1: Are there any differences between the Principal and Agency Models the Committee should be aware of in forming the policies and rules for segregation and portability?

As an end-user of OTC derivatives we expect that our Funds will generally participate in the OTC derivatives clearing process through the use of a financial intermediary. Since the Agency model establishes a primary obligation between end-users and the CCP, as opposed to the Principal model, which imposes a obligation between end-users and a financial intermediary, we consider that the Agency model is more consistent with the objective of establishing an effective CCP infrastructure relative to the segregation of collateral and efficient portability of customer (i.e. end-user) positions. In light of the high probability that Canadian market participants may find themselves clearing through facilities outside Canada, we encourage the Committee to consider policies and rules that will allow for flexibility relative to obtaining access to foreign CCP's that use either model. We also encourage the Committee to consider the potential cost differentials between the models and the impact on the end-user.

Question 2: Should variation margin be required to be provided to a CCP on a gross basis?

While we are sensitive to the potential cost of clearing standardized OTC derivatives, we believe that the adequate collateralization and efficient and timely portability of collateral and positions is essential to the protection of our Fund investors. Though collecting margin on a net basis may result in netting efficiency, in our view the risk that customer positions are under-collateralized and the potential limitations on portability are contrary to the objectives of protecting end-users and effectively mitigating systemic risk. We would not be in favour of arrangements that provide for the submission of end-user collateral to clearing members on a gross basis and the ability of clearing members to post collateral with a CCP on a net basis. We also encourage the Committee to consider the risks associated with the timing of the delivery of end-user collateral by a clearing member to a CCP in the event of a clearing member failure, and to ensure collateral that has not been delivered cannot be used to satisfy claims on the clearing member. Given the laws that apply in the event of the bankruptcy or insolvency of a securities firm in Canada, we are particularly concerned about collateral that is delivered to, and/or held by a clearing member that is a securities firm subject to Part XII of the Bankruptcy and Insolvency Act. We thus agree with the recommendation that variation margin be required to be provided to a CCP on a gross basis and encourage the Committee to consider measures to mitigate the risk associated with the timing of collateral delivery by a clearing member to a CCP.

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Question 3: Do you agree with the Committee's recommendation that CCPs adopt the Complete Legal Segregation Model?

We agree with the Committee's recommendation that CCPs adopt the Complete Legal Segregation Model since the collateral attributed to each market participant would be separately tracked and maintained by the CCP and the financial intermediary (i.e. the clearing member). We also support the notion that the payment and collection of initial margin on a gross basis be part of this model. We favour the concept of the Full Physical Segregation Model as it affords the greatest protection to end-users, but agree that the use of an omnibus account under the Complete Legal Segregation Model results in less cost and administrative burden to market participants and the CCP. We acknowledge that the use of an omnibus account may introduce investment risk not otherwise present in the Full Physical Segregation Model, and encourage the Committee to consider implementing investment management restrictions on end-user collateral to ensure the prudent mitigation of this risk.

Question 4: Are there any benefits to the Full Physical Segregation Model that would make it preferable to the Complete Legal Segregation Model?

We agree with the Committee's view that customer collateral must be safeguarded to the greatest extent possible. Under the Full Physical Segregation Model, where customer collateral is fully segregated and invested in accordance with an agreement between the end-user and the clearing member or CCP, the end-user has more control over its collateral investment risk. This is preferable to the use of a CCP omnibus account where the end-user loses the ability to manage investment risk under the Complete Legal Segregation Model. However, the implementation of prudent regulatory investment rules for customer collateral should serve to mitigate this risk such that the risk will be more than offset by the cost savings implicit in the Complete Legal Segregation Model. We note, however, that the Complete Legal Segregation Model is untested and it is unclear what would happen to customer collateral in the event of a clearing member bankruptcy. We are not confident that the "legally" segregated nature of this arrangement would be respected under current bankruptcy laws. We also note that the Complete Legal Segregation Model heavily relies on the quality of clearing member recordkeeping and we encourage the Committee to consider establishing rules and regulatory oversight and enforcement procedures to ensure customer records are properly maintained by clearing members and subject to periodic audits.

Question 5: Should there be specific permitted investment criteria for customer collateral?

We agree with the Committee's recommendation that the investment of end-user collateral by clearing members and CCPs be restricted to instruments with minimal credit, market and liquidity risk. We also agree that clearing member and CCP investment risk strategies should be disclosed to customers. Due to the size of the OTC derivative market in Canada, we encourage the Committee to examine the impact of implementing investment criteria on Canadian capital markets to ensure there is sufficient supply of high grade, liquid investments to satisfy the requirements.

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Question 6: If yes, what types of investments are suitable for customer collateral held in connection with indirectly cleared OTC derivatives transactions?

In our view, National Instrument 81-102 ("NI 81-102") provisions related to money market fund investments (NI 81-102 Part 1.1) and existing provisions related to securities lending (NI 81-102 Part 2.12 (6)) provide a suitable framework for the development of permitted investment criteria for customer collateral. Included in these requirements are provisions related to credit quality, liquidity, weighted average term to maturity for fixed income instruments and a defined "qualified security" concept that should be considered. We suggest that collateral be denominated in the same currency as the corresponding derivative position(s) and that in contemplating types of collateral that carry more risk, there be provisions requiring higher margin to address the risks associated with collateral realization.

Question 7: Is re-hypothecation of customer collateral consistent with the goals of the Complete Legal Segregation model and should it be permitted?

In our view the re-hypothecation of end-user collateral by clearing members is inconsistent with the Complete Legal Segregation Model, creates undue risk for end-users, and should not be permitted. However, we consider the re-hypothecation of collateral to a CCP solely for the benefit of the end-user in accordance with established and agreed upon CCP rules to be appropriate. We recognize that the inability of a clearing member to re-hypothecate customer collateral may result in increased cost to the end-user, however we believe that the ability to quickly and efficiently recover collateral in the event of a clearing member insolvency is essential.

Question 8: Should clearing members be required to offer collateral holding arrangements with a third-party custodian for customer collateral held in connection with an indirectly cleared OTC derivatives transaction?

As an end-user of OTC derivatives our primary concern is the protection of the interests of our Fund investors and, as such, we are in favour of requiring clearing members to offer collateral holding arrangements with a third-party custodian, as it provides flexibility for end-users and potential opportunities to realize internal operational efficiencies. We recognize that allowing for this option may result in additional operational costs to the clearing member, which will likely be passed on to end-users, but prefer to have the option of establishing collateral holding arrangements with either a clearing member or a third-party custodian. As such, we encourage the Committee to consider an appropriate legal framework that allows for end-user flexibility in choosing either an unaffiliated third party custodian or a custodian affiliated with the clearing member at the end-user's option. In any case it is important to ensure that any party holding customer collateral is subject to adequate regulatory supervision, and required to have robust accounting practices, safekeeping procedures and internal controls and that collateral be protected against the claims of custodian or clearing member creditors. In addition, as mentioned above, it is possible that the use of third-party custodians may help to avoid the treatment under the Bankruptcy and Insolvency Act of collateral held by securities firms.

Question 9: What would be the costs and benefits of a requirement that all Canadian customer collateral be governed by Canadian laws?

There is a clear benefit to implementing governance structures that encourage policy consistency, transparency, and consistent enforcement across provincial jurisdictions. Consistent governance in Canada should create confidence in the clearing process, be aligned with market participant business interests through effective cost management, and encourage liquidity. However, if Canadian governance standards are inconsistent with those of clearing agents outside of Canada, Canadian market participant access to these facilities may be restricted or result in excessive operational and compliance cost. The majority of OTC derivative positions entered into by Canadian market participants are with non-Canadian counterparties and, as such, it is important to ensure that prudent governance does not unnecessarily impede the availability of investment and clearing opportunities in other jurisdictions.

Question 10: Are there any risks that portability arrangements may have on clearing members who accept customer positions in the event of a clearing member default?

We agree with the Committee's recommendation that each provincial market regulator enact rules requiring that OTC derivative CCPs be structured to facilitate the portability of customer positions. We are also supportive of the proposal that portability not require the closing out or re-booking of positions and that porting positions should be done promptly. Since we do not expect Fidelity to be a clearing member, we are not in a position to comment on the risks that portability arrangements may have on clearing members who accept customer positions in the event of a clearing member default.

Question 11: Do you agree with the Committee's recommendation that OTC derivatives CCPs should be required to facilitate portability for customers at their discretion?

We agree that the portability of customer positions and collateral should not be restricted to default situations but should be made available to customers at their discretion. As a large asset management firm, we maintain a proprietary counterparty risk exposure monitoring program and in the event this risk monitoring group provides early detection of a credit event, we may wish to port positions and collateral in advance of such an event occurring. While this may prove to be administratively complex, in our view this flexibility is important to our ability to effectively manage a Fund's counterparty risk exposure. Since this approach is consistent with the CFTC proposal and CPCC IOSCO recommendations, we think it appropriate for the Committee to work toward consistency with these proposals and recommendations.

Question 12: Should OTC derivatives dealers be required to offer arrangements for collateral to be held with a third-party custodian for uncleared transactions?

Consistent with our response to Question 8 above, we are in favour of requiring derivatives dealers to offer collateral holding arrangements with a third-party custodian in connection with uncleared OTC derivative transactions, as it provides end-users with choice. Similarly, we support the notion that any party holding customer collateral should be subject to adequate

regulatory supervision, and be required to have robust accounting practices, safekeeping procedures and internal controls and that collateral should be protected against the claims of custodian or derivatives dealer creditors.

We thank you for the opportunity to comment on these matters. As always, we are more than willing to meet with you to discuss any of our comments.

Yours truly,

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