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March 19, 2014
BY E-MAIL

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

RE: Proposed OSC Rule 24-503 *Clearing Agency Requirements* Comments

Dear Sir:

TMX Group Limited ("**TMX Group**") welcomes the opportunity to comment on OSC Rule 24-503 *Clearing Agency Requirements* (the "**Rule**") in the context of the Ontario Securities Commission's (the "**OSC**") efforts in structuring a regulatory framework for clearing agency oversight. As we detail below, however, TMX Group strongly disagrees with the manner in which the OSC proposes to implement the Committee on Payment and Settlement Systems – International Organization of Securities Commissions' ("**CPSS-IOSCO**") Principles for financial market infrastructures ("**PFMIs**"). We have provided our comments relating to the OSC's general approach and the specifics of the Rule below, and our responses to the OSC's questions in the attached Appendix A.

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 Limited ("**CDS**"), 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 (Montréal, Calgary and Vancouver), in key U.S. markets (New York, Houston, Boston and Chicago) as well as in London, Beijing and Sydney.

General Comments

The most significant concern that TMX Group wishes to express with respect to the Rule is the confusion, complexity and inconsistency resulting from differences, however modest, between the CPSS-IOSCO text and

the proposed OSC Rule. It is not clear to TMX Group why the OSC has explicitly chosen to draft the Rule to be consistent with the terminology and text of the PFMI Report, and to generally incorporate all of the principles and key considerations within the Rule, while incorporating several "additional considerations." TMX Group is also concerned about the additional complexity and inconsistency that will result from regulators in each province taking a different approach to this rule and the operational challenges this will create.

(a) Purposes of the Rule

The OSC has stated that the primary purposes of developing this Rule were: (1) "to set out certain requirements in connection with the application process for recognition as a clearing agency or exemption from the requirements"; (2) "to set out on-going requirements for recognized clearing agencies that act as, or perform the services of, a CCP, CSD or SSS"; and (3) to serve "as an important component of the efforts by the Canadian Securities Administrators (CSA) Derivatives Committee to develop a comprehensive regulatory framework for the trading of derivatives in Canada intended to implement the G20 commitments."

Part 2 of the Rule addresses purpose (1) and Part 3 of the Rule addresses purposes (2) and (3). As purposes (2) and (3) would have been fully served by simply requiring that recognized clearing agencies comply with the PFMI requirements, TMX Group neither understands the reason for, nor sees the value in, the Ontario-specific redrafting of the PFMI requirements. To the extent the OSC believes that additional requirements or considerations are necessary in the Ontario context, such additional requirements should have been added to the rule in a manner that makes it explicitly clear which, and where, the new requirements go beyond the PFMI requirements.

TMX Group, as an essential and critical part of Canadian financial services infrastructure, fully supports the development of Canadian rules implementing the PFMIs; it is in the interest of TMX Group and its clearing agencies to ensure the stability of its infrastructure. Further, the implementation of the PFMIs affords certain banking participants the ability to take advantage of favourable capital requirements which apply when clearing derivative transactions through a qualifying central counterparty ("**QCCP**"). The Basel Committee on Banking Supervision's "Capital requirements for bank exposures to central counterparties" states that a QCCP "is an entity that is licensed to operate as a CCP...subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures." TMX Group respectfully submits that by implementing the PFMI requirements directly, rather than through redrafted or amended transcriptions of the requirements in Ontario-specific rules, the OSC would ensure its oversight capabilities while allowing clearing agencies and participants the advantages relating to being in compliance with the PFMIs and, specifically, QCCP status for certain CCPs.

(b) TMX Group Concerns with Respect to the OSC Approach

The structure of the PFMI implementation in the Rule is of significant concern to TMX Group for several reasons, including:

(1) It is very challenging, confusing and time-consuming to accurately determine how the OSC requirements differ from the PFMI requirements. Even subtle differences between provincial rules and implementation can result in huge compliance challenges, costs and confusion. A variety of entities, in fact, will need to engage in this analysis, including:

a. Canadian clearing agencies, as well as many international clearing agencies which have already engaged in rigorous PFMI analyses to determine their respective degrees of compliance, identify potential gaps, and develop and draft remediation plans. These entities will be required to review this Ontario version of PFMI requirements anew and may be required to revise some of their remediation plans as a consequence.
b. The international task force from CPSS-IOSCO that will be monitoring implementation of the PFMI standards.
c. Banking participants, particularly international banking participants, which may need assurance that the Rule is sufficiently consistent with the PFMI requirements in order to recognize Ontario clearing agencies as QCCPs.
d. Foreign regulators evaluating Canadian equivalency or comparability.

(2) The complexity of this analysis, and the resulting compliance efforts, will be magnified by the impact of each province enacting its own PFMI implementation rule, each of which may be significantly different, with some regulators taking a more principles-based approach and others a more prescriptive approach.

(3) The complexity and associated compliance work resulting from (1) and (2) above may deter participants and clearing agencies from entering or expanding in the Canadian market; the result may even be the potential for less clearing agency competition and less market liquidity and stability as a whole.

(4) Foreign clearing agency exemptions premised on the implementation of PFMI requirements in their home jurisdiction will result in an uneven playing field for Canadian clearing agencies held to the higher standards prescribed in the Rule.

(5) To the extent that the PFMIs, as redrafted in the Rule, may impose a lower standard than the PFMI standards in some areas, such lower standards may impact the ability of a clearing agency to be deemed a QCCP by certain, particularly international, participants; clearing agencies might thus be required to comply with both the original PFMI requirements and the OSC Rule.

(6) It is unclear in the Rule whether clearing agencies which are currently required to comply with the PFMIs pursuant to their respective recognition orders will continue to be subject to the CPSS-IOSCO requirements, whether they will need to comply with the Rule or even both.

Given all of the concerns raised above, the lack of evident benefits resulting from redrafting the PFMI requirements and the simplicity of achieving all of the stated purposes of the Rule, plus the additional benefits to clearing agencies and participants through requiring only that clearing agencies comply with the PFMIs, TMX Group would request that the OSC reconsider the Rule as currently drafted and instead require direct compliance with the original PFMIs. Any additional requirements viewed as necessary could be added to the Rule in a clear and distinct manner and subjected to further comments.

TMX Group would further request that the OSC take a unified approach with the other provincial regulators to drafting and implementing this Rule. The PFMIs themselves impose detailed and complex requirements

upon clearing agencies. Adding to this complexity by enforcing them through different regulations in each province makes operating as a clearing agency in Canada significantly more challenging.

(c) TMX Group Concerns With Prior Written Approvals and Notifications

Section 2.2 of the Rule requires that, prior to a significant change, a recognized clearing agency must receive prior written approval of the OSC and, prior to a fee change, must inform the OSC at least 30 days in advance. This form of advance approval and notification is inconsistent with international regulations and puts recognized Canadian clearing agencies on an unlevel playing field relative to foreign clearing agencies which may make such changes to their business more quickly to provide the services and make the adjustments necessary to compete and meet the needs of the market. Pursuant to CFTC regulations, for example, derivatives clearing organizations need only self-certify rule changes with the CFTC 10 business days in advance of the change. TMX Group respectfully requests that requirements regarding notifications or approvals from the OSC be no more onerous than the CFTC requirements. Numerous US and other foreign clearing agencies already operate on an exempt basis in the Canadian marketplace. If such exempt clearing agencies may make these significant changes to their business and fees both in Canada and in their foreign operations without such delays, Canadian clearing agencies will be at a significant disadvantage domestically and internationally if they cannot keep up with market changes and demands in the same manner.

(d) TMX Group Concerns with Respect to Part 3 Requirements

(i) Comments Regarding Requirements in Excess of the PFMI Requirements

TMX Group notes the following specific issues regarding certain Part 3 requirements in the Rule that are in excess of the PFMI requirements:[1]

Qualifying liquid resources 3.7(8) *Only the following liquidity resources of a recognized clearing agency are eligible for the purpose of meeting the requirements to maintain sufficient liquid resources under subsections (5), (6) and (7): (a) cash in the currency of the requisite obligations, held either at the central bank of issue or at a commercial bank that meets the clearing agency's strict criteria under subsection 3.9(4); (b) committed lines of credit; (c) committed foreign exchange swaps; (d) committed repurchase agreements;*

Regarding (a), there is minimal liquidity risk with respect to major currencies and any potential concerns could be addressed through a foreign exchange haircut allowance if necessary. PFMI principle 3.7.10 contemplates holding liquid resources in more than one currency, but does not strictly require that the currency of the liquid resources must exactly match the currency of the obligations. Further, if highly marketable collateral held in investments are permitted, given the marketability and standardization of major currencies, it does not seem reasonable to require that cash must be held in the same currency of the obligation.

Use of own capital 3.13(8) *A recognized clearing agency that acts as a central counterparty must dedicate and use a reasonable portion of its own capital to cover losses resulting from one or more participant defaults prior to applying the collateral of, or other prefunded financial resources contributed by, the non-defaulting participants.*

[1] For ease of reference, the text of the section regarding which we have commented has been copied in italics prior to our comments.

PFMI rule 3.13.1 states that "In some instances, managing a participant default may involve hedging open positions, funding collateral so that the positions can be closed out over time, or both." PFMI rule 3.13.2 states that "An FMI's default rules and procedures should enable the FMI to take timely action to contain losses and liquidity pressures...Specifically, an FMI's rules and procedures should allow the FMI to use promptly any financial resources that it maintains for covering losses and containing liquidity pressures arising from default including liquidity facilities." These rules contemplate the FMI using its own resources as an option in the management of a default, but do not actually require the FMI to dedicate its own capital to cover losses. While the rule may be intended to ensure that the CCP has "skin in the game" so that it is motivated to act in a manner that would minimize loss and risk to all, given how much reputational risk a clearing agency has at stake as the market watches its response to a default, it is unnecessary to add any additional motivating factor. If a clearing agency mismanages a default, it will likely lose participants and business and may ultimately fail.

(ii) Comments Regarding Other Part 3 Requirements

While TMX Group believes that the OSC should implement the PFMI requirements as originally drafted, to the extent that either this does not occur or there is room for regulatory interpretation or clarification, TMX Group has the following additional comments with respect to certain items:

Collateral – General principle 3.5 (1) A recognized clearing agency that acts as, or performs the services of, a central counterparty or securities settlement system and that requires collateral to manage its or its participants' credit exposure must, (a) accept collateral with low credit, liquidity, and market risks...

It is essential that letters of credit are perceived to be permitted collateral. While nothing in the wording of this principle or the companion policy suggests otherwise, TMX Group would appreciate additional positive clarity in the rule or policy that letters of credit are intended to be included. This would be an approach consistent with market and international practice. For commercial entities in particular that directly clear their own positions, letters of credit provide a cost effective means of meeting collateral requirements. Whereas financial entities maintain assets primarily in the form of liquid investments, cash etc., commercial entities are heavily invested in long term, tangible assets. Accordingly, letters of credit are the primary instruments included in their banking arrangements to facilitate financial assurances for such entities. Exclusion of letters of credit as permissible collateral would result in a significant decrease in cleared transactions by commercial entities, which contrasts with the G20 commitments.

Qualifying liquid resources 3.7(8)

(8) Only the following liquidity resources of a recognized clearing agency are eligible for the purpose of meeting the requirements to maintain sufficient liquid resources under subsections (5), (6) and (7):

(a) cash in the currency of the requisite obligations, held either at the central bank of issue or at a commercial bank that meets the clearing agency's strict criteria under subsection 3.9(4);

(b) committed lines of credit; ...

With respect to Section 3.7(b), we would ask that "committed lines of credit" be expanded to include letters of credit. Letters of credit are, in fact, committed obligations of the underwriting bank and this should be explicitly recognized in the rules.

Testing of default procedures *3.13 (6) A recognized clearing agency must involve its participants and other stakeholders in the testing and review of the clearing agency's default rules and procedures, including any close-out procedures*

For clearing members of a private, non-mutualized clearinghouse[2], the clearing members are clearing for their own accounts and do not provide client services typically afforded by Futures Commission Merchants. Accordingly, in the event of a default and close out, non-defaulting participants are neither impacted nor included in the process. For the defaulting participant, the close out procedures are specifically outlined in the clearinghouse rules and are limited to liquidation of the defaulting party's positions without recourse or impact to any other participant. In such circumstances, participants are unwilling to, and see little value in being included in, testing and review of such procedures. Accordingly, we would request that the involvement of participants as required in Section 3.13(6) is limited to those entities that clear positions for their clients' FCM services or those that are involved in loss mutualization, and not those that clear only their house positions.

TMX Group appreciates the opportunity to provide comments with respect to the Rule and looks forward to further dialogue on clearing agency requirements generally. We hope that you will consider our concerns and suggestions and would be happy to discuss these at greater length. Please feel free to contact Steve Lappin at steve.lappin@ngx.com, George Kormas at gkormas@cdcc.ca or David Stanton at dstanton@cds.ca if you have any questions regarding our comments.

Respectfully submitted,

Jim Oosterbaan President and CEO, Natural Gas Exchange Inc.	Alain Miquelon Managing Director, CDCC Group Head of Derivatives Markets, TMX Group TMX Group	Jean Desgagne President and CEO, The Canadian Depository for Securities Limited

cc: William S. Rice, Canadian Securities Administrators

[2] Private, non-mutualized clearinghouses are those which allow all clearing members to self clear and do not mutualize the risk of loss amongst the clearing members. Instead, financial resources contributed to the default waterfall, excluding collateral posted to cover each clearing member's own exposures, are provided exclusively by the clearinghouse.

Appendix A - Responses to OSC Questions

Question 1: Are there other factors that could be considered by the Commission in determining the systemic importance of a clearing agency to Ontario? If so, please describe such factors and your reasons for including them.

Two key components which should not be overlooked in any determination or assessment of the systemic risk of a clearing agency are (a) the extent to which failure of a CCP would require the use of public funds to maintain the stability of Canada's financial infrastructure and (b) the impact a clearing house failure would have on Canada's financial infrastructure as a whole.

Question 2: Do you agree with the current drafting approach of section 3.14 of the Rule, ie, requiring all CCPs to meet Principle 14 in its entirety (without referencing the alternate approach), and granting exemptions on a case-by-case basis to those CCPs for which the alternate approach is appropriate?

TMX Group's strong position is that its cash market does not require an "exemption" from the requirements of Principle 14 as it meets the investor protection requirements of the principle via the alternate approach. The text of PFMI Principle 14 clearly provides the alternative approach is just that - an alternative way to meet the requirements of Principle 14. There is no need to "exempt" cash markets that meet the requirements for the use of the alternate approach. The use of an "exemption" inappropriately implies a weaker approach to investor protection and is inconsistent with the approach taken by CPSS-IOSCO in the PFMIs.

TMX Group feels that all CCPs servicing similar markets should be held to equivalent standards vis-à-vis Principle 14; uniform application of the PFMI requirements will ensure a level international playing field for CCPs which service client trading activities. It is unclear why the OSC felt it appropriate to eliminate the ability to rely upon an alternate approach which was determined by CPSS-IOSCO, following extensive analysis and input, to appropriately manage risk to the same extent as the regular approach.

Question 3: Should all CCPs serving the Canadian cash markets be able to avail themselves of the alternate approach to implementation of Principle 14? How could such CCPs demonstrate that customer assets and positions are protected to the same degree envisioned by Principle 14?

All CCPs servicing the Canadian cash markets should be able to avail themselves of the alternate approach to implementation of Principle 14, but should be able to do so by demonstrating the means by which they meet the specific criteria provided in Principle 14. Those criteria are specified in section 3.14.6 of the PFMIs as follows: (a) the customer positions can be identified timely, (b) customers will be protected by an investor protection scheme designed to move customer accounts from the failed or failing participant to another participant in a timely manner, and (c) customer assets can be restored.

We would also like to note the very significant implications to CDS and the cash markets it serves should it be unable to avail itself of the alternative approach to achieve compliance with Principle 14. As a CCP, CDS operates its Continuous Net Settlement (CNS) service which provides very important netting benefits for users of this service. This netting provides efficiencies for the use of credit to support settlements and system performance efficiencies. By applying the requirements of Principle 14 to CDS without the ability to use the alternate approach, these important efficiencies would be lost with significant detrimental impact to its participants and their service providers. Furthermore, by reducing the netting efficiencies, the margin requirements of the users of the CNS service would be dramatically increased. We note that the OSC has explicitly acknowledged the potential for these unintended consequences in the preamble to this question.

Question 4: What are a clearing agency's current abilities and future prospects to meet the objective of recovering and resuming critical systems and processes within two hours of a disruptive event? Should recovery and resumption-time objectives differ according to critical importance of markets?

As an initial matter, this is consistent with requirements of the PFMIs and, to properly respond, TMX Group would request further clarity as to whether the ability of a Canadian FMI to meet a clearly established requirement in the PFMIs would impact how the PFMIs are applied and whether more than two hours to recover may be permitted if necessary.

If regulators believe that they may be flexible in their interpretation of this principle, we would submit that the two hour timeframe appears to be arbitrary to some degree and may not be the appropriate time recovery objective in Canada.

Question 5: To what extent can a CCP identify and gather information about a tiered (indirect) participant?

As an initial matter, this requirement is also consistent with the requirements of the PFMIs and, to properly respond, TMX Group would request further clarity as to whether the ability of a Canadian FMI to meet this established requirement in the PFMIs would impact how the PFMIs are applied. TMX Group respectfully requests that the OSC clarify the types, and the extent, of information forming the object of this question.

If regulators believe that they may be flexible in their interpretation of this principle, we would submit that it is challenging for Canadian CCPs to identify or gather meaningful information pertaining to indirect participants; in addition to the lack of a legal or other contractual relationship between the CCP and the second order market participants, Canadian clearing models are founded on the principal model; direct participants have historically managed their CCP relationships on an omnibus basis. While the principal model, which employs an omnibus account structure, allows for the distinction between proprietary and client assets (with, for example, a participant's ability to segregate fully-paid up client securities), more granular detail would be necessary in order to permit CCPs to identify and measure the activity of tiered/indirect participant appropriately. While a CCP may, in certain specific and limited circumstances, require disclosure of material changes to the business of its direct participants, and may also request information related to a participant's clients (when asked for a declaration of residency in respect of restricted securities, for example), CCPs have limited recourse to require information disclosure from indirect participants.

Question 6: In Canada, what types of risks (such as credit, liquidity, and operational risks) arise in tiered participation arrangements between customers and direct participants or between customers and other intermediaries that provide clearing services to such customers?

All of the cited risks - credit, liquidity and operational - are present in tiered participation arrangements in Canada.

Question 7: How can a clearing agency properly manage the risks posed by tiered participation arrangements?

The control, mitigation, and management, by a CCP itself, of the various risks associated with tiered participation arrangements would require, at a minimum, the disclosure of client accounts and/or securities positions by direct CCP participants. Such disclosure would, in principle, provide a CCP with the relevant information to meet the minimum standards of Principle 14 and would allow a CCP to modify or calibrate its

risk model towards the effective management of the credit and liquidity risks that tiered participants introduce into the clearing system.

Question 8: Are the above transition periods appropriate? If yes, please give your reasons. If not, what alternative transition periods would balance the CPSS-IOSCO's expectation of timely implementation of the PFMIs and the practical implementation needs of our markets?

For certain CCPs, the segregation and portability timelines, as presented, are not entirely clear and successful implementation within the prescribed transition period(s) may be prove difficult. In addition, where a CCP has already completed significant preparatory work and/or dedicated resources to implementation plans that have been approved by the CCP's regulator, the transition periods should take such efforts into account. In certain circumstances, where the OSC's implementation of the PFMIs differs from the CPSS-IOSCO PFMI text, TMX Group respectfully suggests that the OSC provide a mechanism through which PFMI requirements that are substantively similar to the OSC requirements be grandfathered under the Rule.