Canadian Life and Health Insurance Association Inc.

Association canadienne des compagnies d'assurances de personnes inc.

March 19, 2014

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

Me Anne-Marie Beaudoin
Secrétaire de L'Autorité
Autorité des marchés financiers
800 square Victoria, 22e étage
C.P., 246 Tour de la Bourse
Montréal, Québec
H4Z 1G3

DELIVERED VIA E-MAIL: comments@osc.gov.on.ca
Consultation-en-cours@lautorite.qc.ca

Dear Sir/Madam:

CSA Staff Notice 91-303; CSA Staff Notice 91-304; and Proposed OSC Rule 24-503

The Canadian Life and Health Insurance Association is pleased to provide comments on Canadian Securities Administrators' ("CSA") Staff Notice 91-303, Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives, CSA Staff Notice 91-304, Model Provincial Rule Derivatives: Customer Clearing and Protection of Customer Collateral and Positions, and Proposed OSC Rule 24-503, Clearing Agency Requirements.

Established in 1894, the Canadian Life and Health Insurance Association (CLHIA) is a voluntary trade association that represents companies which together account for 99 percent of Canada's life and health insurance business. The industry, which provides employment to more than 142,000 Canadians and has investments in Canada of about $615 billion, protects almost 27 million Canadians through products such as life insurance, annuities, Registered

1 Queen Street East
Suite 1700
Toronto, Ontario
M5C 2X9

Tel: (416) 777-2221
Fax: (416) 777-1895
www.clhia.ca

1, rue Queen Est
Bureau 1700
Toronto (Ontario)
M5C 2X9

Tél.: (416) 777-2221
Fax: (416) 777-1895
www.accap.ca

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Retirement Savings Plans, and disability insurance and supplementary health plans. It pays benefits of over $66 billion a year to Canadians and manages about two-thirds of Canada's private pension plans. Canadian life insurance companies participate as end-users in Canadian and foreign derivatives markets.

The CLHIA is in general agreement with the CSA's suggested approach for central counterparty clearing of OTC derivatives that are appropriate for clearing and capable of being cleared, and protection of customer collateral as these represent a direction which will improve transparency and enhance the overall mitigation of risks. The CLHIA has several comments which are outlined below.

Rule 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives and Proposed OSC Rule 24-503 Clearing Agency Requirements

Since the definition of a financial entity in Rule 91-303 includes an insurance company and the end-user exemption does not apply to a transaction if one of the counterparties is a financial entity, life insurers understand that they will need to use a central counterparty to clear any derivative that has been determined to be required to be centrally cleared.

As previously stated, the life and health insurance industry has a significant concern in the context of clearing standardized derivatives regarding the requirements for initial and variation margin. The investment portfolios of life insurance companies contain long dated corporate securities to support the long term nature of their liabilities, which are unique to the life insurance industry. It will be particularly challenging for life insurers to hold the short-term liquid assets necessary to post the types of collateral that clearinghouses generally demand. In order to reduce the strain on life insurers' balance sheets, it is important that Rule 24-503 permit clearing agencies to provide the necessary flexibility with respect to eligible collateral, which should include the types of assets that life insurance companies hold, for instance, high grade corporate bonds. Maintaining sufficient liquid collateral in short-term assets would constitute a significant cost to the life insurance industry and impact its ability to match the long term nature of its liabilities in accordance with prudent asset liability management practices.

<u>Reporting of Information to the Local Securities Regulator</u>

Part 4 of Rule 91-303 outlines disclosure and reporting requirements to be made by a clearing member, clearing intermediary or derivatives clearing agency to customers, and the applicable local securities regulator. It is not clear whether there would be any public access to the Customer Collateral Reports (which appear to contain details of collateral positions for each customer). It is also unclear whether clearing agencies, members and intermediaries will be required to file reports in each province in which they do business with respect to all of their customers, or with respect to those customers whose head office or principal place of

business is located in that province. There would also appear to be duplication in that the information contained in the reports of clearing agencies would also be contained in the reports filed by the clearing members of such agencies.

Insurers are very concerned about maintaining the confidentiality of information which is reported. Particularly in the smaller jurisdictions, access to information contained in Customer Collateral Reports could possibly result in an unwanted disclosure of trading strategies or an inadvertent indirect disclosure of significant strategic transactions before they are required to be publicly disclosed. Insurers would like assurance that all reported customer collateral information will be kept strictly confidential.

Intragroup Exemption

Section 8(3) of Rule 91-303 states that a counterparty that is relying on the intragroup exemption must annually submit to the applicable local securities regulator a completed intragroup exemption form. Intragroup transactions generally consist of back-to-back transactions used by corporate groups to structure their affairs to manage liabilities and achieve tax effectiveness and don't have any market conduct or consumer protection implications. Many life insurance companies are federally regulated and therefore, in these instances, any prudential concerns would be more appropriately addressed by the federal prudential regulator. For federally regulated life insurance companies, OSFI would be the appropriate regulator to monitor intragroup transactions. An additional layer of provincial securities regulation, including annual exemption filings, should be avoided.

91-304 – Model Provincial Rule Derivatives: Customer Clearing and Protection of Customer Collateral and Positions

The CLHIA agrees with the requirement that a derivatives clearing agency must keep customer collateral segregated from its own property. The CLHIA also agrees with the requirement that a derivative-clearing agency must not use customer collateral of a customer to margin, guarantee, secure, settle or adjust cleared derivatives of a person or company other than the customer.

Section 3(2) permits the customer collateral of multiple customers to be commingled in an omnibus customer account but requires the clearing agency through its record keeping requirements to be able to identify the positions and collateral held for each individual customer. Following on the original discussion in Consultation Paper 91-404, the Rule is adopting the Complete Legal Segregation Model.

CLHIA believes that the Rule should allow the option for customers to request operation under the Full Physical Segregation Model. Although this model is more expensive, it provides the most safety. In some circumstances, using the Full Physical Segregation Model

may result in the requirement for less administration. The Full Physical Segregation Model also provides the best protection against malfeasance and fraud.

Section 9 permits a derivatives clearing agency to invest customer collateral in a permitted investment. A customer should be permitted the ability to restrict how collateral will be invested.

The CLHIA appreciates the opportunity to provide its comments. If you require any additional information at this time, please feel free to contact me by e-mail at JWood@clhia.ca or by telephone at 416-359-2025.

Yours truly,

"James Wood"

James Wood
Counsel