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Re: CSA Staff Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives

INTRODUCTION

The Canadian Market Infrastructure Committee ("CMIC") welcomes the opportunity to comment on the Canadian Securities Administrators' ("CSA") Derivatives Committee (the "Committee") Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives dated December 19, 2013 (the "Rule").[1]

CMIC was established in 2010, in response to a request from public authorities, to represent the consolidated views of certain Canadian market participants on proposed regulatory changes. The membership of CMIC consists of the following: Bank of America Merrill Lynch, Bank of Montreal, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Deutsche Bank A.G., Canada Branch, Healthcare of Ontario Pension Plan, HSBC Bank Canada, JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Royal Bank of Canada, The Bank of Nova Scotia, The Fédération des Caisses Desjardins du Québec, and The Toronto-Dominion Bank.

[1] Canadian Securities Administrators, CSA Staff Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (2013) 36 OSCB 12025. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20131219_91-303_mandatory-counterparty-clearing-derivatives.pdf.

CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian OTC derivatives market. The membership of CMIC has been intentionally designed to present the views of both the 'buy' side and the 'sell' side of the Canadian OTC derivatives market, including both domestic and foreign owned banks operating in Canada. As it has in all of its submissions, this letter will reflect the consensus of views within CMIC's membership about the proper Canadian regulatory regime for the OTC derivatives market. However, individual CMIC members (or groups of them) may be submitting separate submissions with respect to their additional individual comments and concerns with this Rule.

OTC derivatives are an important product class used by both financial intermediaries and commercial end-users to manage risk and exposure. Systemic risk oversight of the OTC derivatives markets is an essential component of the long term financial stability and growth of Canadian financial markets and their participants.

CMIC appreciates the consultative approach being taken by the CSA in considering the proposed regime for mandatory central clearing of OTC derivatives. CMIC believes that this approach will lay the foundation for the development of a Canadian regulatory structure[2] that will satisfy Canada's G-20 commitments by addressing systemic risk concerns in OTC derivatives markets.

OVERVIEW

As mentioned in our prior CSA consultation papers[3], CMIC recognizes the importance of central counterparty ("CCP" or "clearing agency") clearing of OTC derivatives in the global effort to reduce systemic risk. Many CMIC members currently participate in central clearing platforms and, in advance of any legal requirement, are increasingly operating in a manner that complies with G20 clearing commitments. We encourage the CSA to continue to work closely with its global counterparts and other international bodies towards the common goal of meeting the G20 commitments. Having a Canadian regime that is not aligned with global standards would place Canadian participants at a severe competitive disadvantage. Further, we continue to emphasize the need for coordination and cooperation between federal and provincial and territorial regulators to allow each level of government

[2] References to "regulation" or "regulators" within this document will be considered to include market, prudential and systemic risk regulators.

[3] Response of CMIC dated September 9, 2011 to the consultation paper relating to OTC derivatives trade repositories. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20110909_91-402_cmic.pdf;
Response of CMIC dated January 25, 2012 to the consultation paper on surveillance and enforcement. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120125_91-403_cmic.pdf;
Response of CMIC dated April 10, 2012 to the consultation paper on segregation and portability in OTC derivatives clearing. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120410_91-404_cmic.pdf;
Response of CMIC dated June 15, 2012 to the consultation paper on end user exemptions from certain regulatory requirements. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120615_91-405_cmic.pdf;
Response of CMIC dated September 21, 2012 to the consultation paper on central clearing counterparties (the "CCP Response Letter"). Available at http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20120921_91-406_cmic.pdf;
Response of CMIC dated February 4, 2013 to the model rules (the "Initial Model Rules") on product determination (the "Initial Model Scope Rule") and trade repositories and data reporting (the "Initial Model TR Rule"). Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20130204_91-301_cmic.pdf;
Response of CMIC dated June 17, 2013 to the consultation paper relating to registration of derivatives market participants. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20130617_91-407_cmic_en.pdf.

to discharge effectively its respective jurisdictional responsibilities in relation to OTC derivatives in a harmonized manner.

MODEL RULE – DISCUSSION

Legislative Changes

In our response letter dated September 21, 2012 to CSA Consultation Paper 91-406[4] (the "CCP Response Letter") CMIC indicated that, in its view, there are changes to the existing regulatory and legislative framework that are needed to accommodate a move to CCP clearing and to facilitate the efficiency of OTC derivatives clearing. In that response letter, we summarized the fundamental legislative requirements as follows:

- Provincial personal property security acts are required to be amended to address the perfection of security interests in cash collateral by way of control, allowing Canadian trades to have the same perfection regime as US trades;

- Confidentiality of trade information needs to be addressed so that reporting to trade repositories and clearing agencies does not cause contractual breaches; and

- Amendments are required to the *Payment Clearing and Settlement Act* (Canada) ("PCSA") and other federal insolvency laws to properly manage systemic risk and to ensure that, in the event of a clearing member insolvency, indirect customer clearing in Canada operates as expected such that a CCP is able to facilitate expeditiously the termination of clearing member relationships and successfully porting customer positions and enforcing collateral rights in accordance with its clearing rules.

Since submitting our CCP Response Letter, confidentiality of trade information has been addressed in the new trade reporting rules[5] and certain amendments[6] have been made to the PCSA to facilitate central clearing of standardized OTC derivatives. However, amendments have not been made to provincial personal property security acts to address the perfection of security interests in cash collateral by way of control. If these amendments are not made, central clearing arrangements will not work effectively and will not achieve their intended purpose. As a business matter, we understand that the absence of such perfection and priority over cash collateral currently causes certain global banks and other financial institutions to impose higher pricing on trades involving Canadian counterparties to compensate for this Canadian risk.

In addition, we noted in our CCP Response Letter that legislative amendments may be required at both the federal and provincial level to ensure that collateral pledged by clients to a clearing member and rehypothecated by the clearing member to a clearing agency in respect of such clients' trades is protected in the event of the insolvency of such clearing member.[7] Such legislative amendments have not been made.

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[4] Ibid.

[5] Ontario Securities Commission and Manitoba Securities Commission Rule 91-507 ("Rule 91-507") and Trade Repositories and Derivatives Data Reporting, and Autorité des marchés financiers Regulation 91-507.

[6] Bill C-45, the *Jobs and Growth Act, 2012* (S.C. 2012, c. 31), ss. 166-172.

[7] Most provincial personal property security laws allow rehypothecation of collateral, however, if a secured party rehypothecates collateral and subsequently goes bankrupt, the pledgor only has an unsecured claim against the secured party for a return of such collateral. Amendments would therefore be required to allow the pledgor to face the CCP directly in respect of any returns of collateral in the event of the insolvency of such clearing member.

With respect to Canada's three federal insolvency statutes (i.e. *Winding-up and Restructuring Act, Bankruptcy and Insolvency Act* and *Companies' Creditors Arrangement Act*), we noted in our CCP Response Letter that amendments should be made to exclude fraudulent preference claw-backs, crown and other super priority liens and deemed trusts from being applicable to OTC derivatives transactions cleared through CCPs. Corresponding and complementary amendments to such insolvency statutes must also be implemented to ensure that termination and netting rights in respect of such cleared OTC derivatives transactions operate as expected notwithstanding that a member of a clearing agency may become subject to insolvency proceedings. To the extent that members of clearing agencies may become subject to foreign insolvency proceedings, amendments may also be necessary to the provisions of Canadian insolvency laws that govern the terms of recognition of foreign insolvency proceedings to ensure that legal arrangements governing the operations of clearing agencies as a designated clearing and settlement system will result in the expected outcome notwithstanding the foreign insolvency proceedings.

Since submitting our response letter, none of the above amendments to federal insolvency legislation have been made. We note that the Insolvency Institute of Canada Task Force on Derivatives (the "IIC Task Force") has issued a paper[8] making certain recommendations that are relevant to the central clearing of OTC derivatives. CMIC endorses[9] the following recommendations of the IIC Task Force relating to central clearing:

- The definitions of "clearing house", "clearing member" and "margin deposit" in Section 95(3) of the BIA should be expanded to cover derivatives clearing houses that clear derivatives transactions;

- Financial collateral should have priority over the super-priority liens for certain wages and pension amounts under the BIA and the deemed trusts in favour of the Crown pursuant to the *Income Tax Act*, the *Canada Pension Plan* and the *Employment Insurance Act* and substantially similar provisions of provincial legislation.

- The receivership provisions in the BIA should be amended to provide protection to eligible financial contracts to ensure that a court does not have the power to stay a solvent counterparty from terminating an EFC, calculating net termination values and netting or setting-off and dealing with financial collateral.

- Section 88 of the BIA should be amended to apply to receiverships. The BIA should protect financial collateral to ensure that financial collateral posted with or pledged to secure an EFC is not primed by charges granted pursuant to a receivership order, including provisions granting a super-priority charge to a receiver in respect of the receiver's borrowings and the receiver's and other professional's fees.

Definition of "Clearable Derivative"

As mentioned above and in our prior submissions, it is critical that Canadian rules implementing G20 commitments be consistent with global standards. We note that the Rule is currently silent with respect to which types of transactions will be listed on Appendix A as "clearable derivatives". It is CMIC's view that this list should be consistent with the current list of mandatorily clearable derivatives in the US and Europe.

[8] Insolvency Institute of Canada, *Report of the Task Force on Derivatives*, September 26, 2013. Available at http://www.insolvency.ca/en/iicresources/resources/IIC_Derivatives_Task_Force_Report_November_2013.pdf.

[9] CMIC notes that the IIC Task Force has also made other recommendations which are not endorsed by CMIC.

Financial Entity Definition

Paragraph (d) of the definition of "financial entity" refers to a statutory entity that is an agent of the federal or provincial government that provides management services. The explanatory guidance states that this refers to Canadian institutional funds created by federal or provincial legislation which would not necessarily be a pension fund under paragraph (c). We note that the definition states that the statutory entity is an "agent of the federal or provincial government", which means that the counterparty to the derivatives transaction is in fact the federal or provincial government. However, section 11 of the Rule states that the clearing requirement under section 4 does not apply to a transaction if one of the counterparties is the government of Canada or of a province or territory. CMIC therefore submits that paragraph (d) of the definition of "financial entity" needs to be further clarified in light of the non-application provision in section 11.

Hedging of Commercial Risk

Section 3 of the Rule sets out what is meant when a derivative is held for the purpose of hedging or mitigating commercial risk. One of the conditions that must be satisfied is that the derivative establishes a position which is intended to reduce risks relating to the commercial activity or treasury financing activity of the counterparty or of an affiliate and meets any of the tests set out in subparagraphs (i) and (ii). Subparagraph (ii) provides that the derivative covers the risk arising from the indirect impact on the value of assets, services, inputs, products, commodities or liabilities referred to in subparagraph (i), resulting from fluctuation of "interest rates, inflation rates, foreign exchange rates or credit risk". The list of items at the end of subparagraph (ii) does not appear to cover all the risks which might impact the value of such assets, services, inputs, products, commodities or liabilities. For example, changes in commodity prices and equity prices are not referenced and may not otherwise be covered by the other factors listed in subparagraph (ii). Further, it is CMIC's view that a more flexible approach should be adopted in listing the types of risk which a derivative may cover. Accordingly, CMIC recommends that section 3(a)(ii) of the Rule should be revised to read: "…resulting from fluctuation <u>in</u> interest rates, inflation rates, foreign exchange rates, credit risk, <u>commodity prices and equity prices, and other similar rates, risks, levels and prices</u>".

<u>Drafting:</u> In the second to last sentence of the second paragraph under section 3 of the explanatory guidance, there is a reference to the "Committee" being responsible for looking at the facts and circumstances that exist at the time a transaction is executed, however, that reference should instead be to the applicable securities regulator.

End-User Exemption – Small Financial Entities

The Rule provides an exemption in section 7(1) from the clearing requirement to non-financial entities in certain circumstances. Such exemption is not available to any financial entities, regardless of size or their functional role in the derivatives market. The Committee seeks guidance as to whether the proposed non-eligibility of small financial entities for purpose of this exemption is appropriate. As stated in the staff notice to the Rule, the purpose of this exemption is to relieve market participants that are not in the business of derivatives trading but trade in OTC derivatives to mitigate commercial risks related to their business from the mandatory central counterparty clearing.[10] In CMIC's view, such an exemption for small financial entities is appropriate. The purpose of mandatory central clearing is to reduce systemic risk. These small financial entities are often not market-makers in OTC derivative transactions and are usually entering into derivatives for the purposes of hedging or mitigating commercial risk. For example, we understand that the majority of OTC derivative

[10] *Supra.,* note 1, at 12016.

transactions entered into by small Canadian banks are for purposes of offering customers longer-term fixed rate financing by way of swaps offered in connection with the customers' commercial loans. For the most part, the related swap generally will hedge interest rate risk and is not speculative in nature and generally is low risk. These small banks will then enter into swaps with larger financial institutions, often on a back-to-back basis, in order to hedge the underlying risk of the customer swaps. These back-to-back swaps pose low risk to the small banks as their purpose is to hedge its interest rate risk under the customer swap. Often the customer swaps are secured by the same assets used to secure the loan, and often, such assets are relatively illiquid. Unless an exemption is introduced, the small bank would not be able to rehypothecate the collateral received from the customer as collateral under a cleared back-to-back swap. The small bank would therefore be required to separately fund the collateral posted to the CCP which will, when added to the other costs of clearing the swap, represent a disproportionately higher cost of clearing a transaction that is ultimately low risk. In the end, such costs would be passed along to the commercial customer. For these reasons, it is CMIC's view that the end-user exemption should be available to small financial entities. From a systemic risk perspective, these trades are still reportable and thus Canadian regulators are still able to monitor the impact of such trades on the Canadian OTC derivatives market.

In determining whether a financial entity is considered "small", CMIC encourages the CSA to consider using a *de minimis* test based on the overall level of OTC derivatives market activity of a particular financial entity. Any threshold determined by the CSA should reflect the realities of the Canadian OTC derivatives market. For instance, adopting a Dodd-Frank threshold of $10 billion in total assets for the purposes of determining whether an entity falls within the "small financial institutions" category would not be appropriate given the smaller size of the Canadian OTC derivatives market.

End-User Exemption – Pension Funds

As mentioned previously, CMIC is supportive of central clearing and recognizes its importance in reducing systemic risk.

Pension funds seek longer term stability in their investments and are driven by the necessity to hedge against their pension liabilities by generating targeted returns at acceptable levels of risk. They are end-users of OTC derivatives and are not in the business of dealing in derivatives. Due to restrictions on the use of leverage and limited financial market interconnectedness, CMIC believes there should be little likelihood that the use of OTC derivatives by pension funds poses systemic risk to Canadian financial markets. Generally speaking, pension funds are statutorily prohibited from borrowing money, other than in certain limited circumstances, and thus, they operate at a fraction of the level of leverage used by derivatives dealers and other market participants. For these reasons, we are recommending that the CSA should study the issue of whether the use of derivatives by pension funds creates or increases a material likelihood of systemic risk.

It is therefore CMIC's view that, similar to the approach taken under EMIR,[11] which in effect enables pension funds to meet daily variation margin calls without the need to make cash payments (thus permitting such funds to utilize their cash holdings for investment purposes), the clearing requirement should not be imposed on pension funds for a period of three years (or such longer period as may be required to resolve regulatory issues relating to non-cash settlement of variation margin) after the date the clearing requirements become effective. All OTC derivatives entered into by pension funds that are local counterparties will still be reported to trade repositories. As is the case under EMIR, the

[11] Article 89(1) of EU Regulation No. 648/2012 (July 4, 2012). Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

three year period would allow regulators to gather the relevant data from trade repositories in order to determine the impact of the derivatives trading activity of pension funds on systemic risk. The mandatory clearing requirement for pension funds could be revisited at the end of such three year period.

Affiliate End-User Exemption

Many end-users execute a significant portion of their hedge transactions through affiliated or wholly-owned centralized treasury units. These centralized treasury units allow companies to manage commercial, operating and credit risk more effectively. Benefits include centralized cash management, netting exposures on a group basis and securing better pricing on behalf of affiliates. Structures will differ between companies, but centralized treasury units will typically serve as the primary external market-facing entity by entering into a derivatives transaction as principal and then enter into a back-to-back principal transaction with the applicable end-user affiliate for whom the derivatives transaction serves as a hedge.

Section 7(2) of the Rule sets out an exemption (the "Affiliate End-User Exemption") available to an affiliate (i.e. the centralized treasury unit) of the person or company that qualifies for the end-user exemption in Section 7(1). This Affiliate End-User Exemption is available only if the affiliated entity is "acting as agent on behalf of the person or company". As mentioned above, centralized treasury units will enter into market-facing transactions as principal and then enter into a back-to-back principal transaction with the relevant end-user affiliate. CMIC assumes that the Affiliate End-User Exemption would be available to the centralized treasury unit in this principal back-to-back structure notwithstanding the use of the phrase "acting as agent on behalf of the person or company". The reason for this assumption is that if such market-facing transaction were entered into by the centralized treasury affiliate as agent, then the transaction would already qualify for the end-user exemption under section 7(1) and the centralized treasury affiliate would not need a separate exemption. CMIC recommends that the wording of section 7(2)(a) be clarified by removing the reference to "agent" and indicating in the explanatory guidance that the Affiliate End-User Exemption would be available to affiliates using the principal back-to-back structure.

Drafting comment: In both section 7(1), the word "and" is missing from the end of sub-paragraph (a) and in section 7(2), it is missing from the end of sub-paragraph (b).

Non-Application to Government Entities

Under section 11 of the Rule, the clearing requirement does not apply to transactions where one of the counterparties is the government of Canada, a government of a province or territory of Canada, a crown corporation or an entity wholly owned by the federal or provincial government whose obligations are guaranteed by the federal or provincial government. CMIC would like clarification as to the CSA's intention in excluding from the clearing requirement all entities that are "wholly owned by the federal or provincial government whose obligations are guaranteed by the federal or provincial government". CMIC submits that this would exclude a large universe of Canadian market participants from the clearing requirement that are very active in the OTC derivatives market.

In addition, CMIC notes that this provision could exclude from the clearing requirement government entities that are market-makers with a significant OTC derivatives portfolio. Such entities may not necessarily enter into OTC derivatives transactions for hedging purposes. Excluding such transactions simply because one of the counterparties is a government entity appears to be inconsistent with the goal of central clearing, which is to reduce systemic risk.

As mentioned above, it is CMIC's view that exemption from the clearing requirement for a transaction should be available to any entity as long as it is not in the business of dealing in derivatives and is otherwise entering into such transaction for the purposes of hedging or mitigating commercial risk. Accordingly, CMIC recommends that the Committee consider limiting the application of section 11 only to those government entities whose OTC derivatives portfolio is not in excess of a certain threshold, whether such OTC derivatives transactions are used for hedging or market-making purposes. Moreover, if a government entity is a "derivatives dealer" (as such term is defined under Rule 91-507), the clearing requirement under section 4 of the Rule should apply to all of such government entity's trades.

Reliance on Representations

As noted above, the clearing requirement under section 4 of the Rule does not apply if any of the exemptions under sections 7(1), 7(2) or 8 apply, or if the non-application provision under section 11 applies. As there are very specific conditions precedent which must be satisfied before any of those provisions apply, it is CMIC's view that a party to an OTC derivatives transaction should be able to rely on representations made by the other party, without any further investigation or documentation, in order to determine whether the clearing requirement applies. CMIC recommends that the Rule and the explanatory guidance be revised to address this point.

Substitute Compliance

The Rule provides in section 4(2) that a local counterparty can satisfy the clearing requirement in respect of a transaction if (a) the transaction is required to be cleared solely because the counterparty to the transaction is an affiliate of an entity that is organized or has a principal place of business or head office in Canada and that Canadian entity is responsible for the liabilities of the affiliated entity, and (b) the transaction is submitted for clearing pursuant to the laws of another Canadian province or the laws of a foreign jurisdiction listed in Appendix B (in either case, "Foreign Law"). In CMIC's view, this substitute compliance provision in section 4(2) has limited benefit since, pursuant to section 2 of the Rule, the transaction is still required to be cleared using a clearing agency recognized (or exempt from recognition) under the laws of the applicable province. The purpose of substitute compliance is to deem compliance with applicable provincial law if a foreign entity complies with applicable Foreign Law. Therefore, substitute compliance would be beneficial if, using the example of an Irish affiliate of a Canadian bank, (a) such affiliate complies with the clearing requirement under EMIR and clears its transactions with a clearing agency in Europe (which may or may not be recognized or exempt from recognition under applicable provincial law provided that clearing agency is properly recognized under EMIR) and such compliance under EMIR automatically satisfies the clearing requirement under the Rule, or (b) such affiliate is exempt from clearing under EMIR, takes the appropriate steps under EMIR (if any) to rely on such exemption and such compliance under EMIR automatically satisfies the clearing requirement under the Rule (without requiring that such affiliate file any forms or take any other steps it would otherwise be required under the Rule to qualify for the exemption). Accordingly, CMIC recommends that the Committee reconsider the mechanics of the substitute compliance provision of section 4(2)**.**

In addition, CMIC is of the view that the substitute compliance provisions of the Rule should be expanded to deem that a "local counterparty" (as defined under paragraph (a) or (b) of that definition) has satisfied its clearing requirement in respect of a transaction if the counterparty to that transaction is not a "local counterparty" and, under the applicable Foreign Law, such transaction is exempt from clearing because the counterparty qualifies for an exemption under such Foreign Law. Without this change, Canadian mandatory clearing rules could have the effect of prevailing over foreign rules applicable to a foreign counterparty with the result that an end user would be forced to clear its derivative pursuant to Canadian rules, even if exempt from clearing under its local rules. A good

example of this problem is presented by a swap between a Canadian bank (or its offshore affiliate that is a local counterparty under the Rule) and a European pension fund (that currently enjoys an exemption from clearing under EMIR, as referenced above). This extraterritorial effect could significantly harm the Canadian OTC derivatives market by driving such foreign counterparties away from entering into derivatives with Canadian market participants.

Rejection of a Transaction by a Clearing Agency

Section 5 of the Rule provides that a clearing agency must "immediately" notify the local counterparty or local counterparties submitting the transaction if it rejects the transaction. First, it may be possible that it is not the local counterparty that is submitting the transaction for clearing and therefore section 5 should be amended to remove the references to "local". Second, the term "immediately" is imprecise and needs further clarification. Finally, the explanatory guidance provides that if a transaction is rejected by a clearing agency, the Committee considers that the transaction is void *ab initio.* It is CMIC's view that this should not automatically be the outcome. While the aspect of global derivative reform remains influx, we note that the current CFTC requirement that a rejected trade be considered void *ab initio* applies only in the context of a derivative traded on either a designated contract market (DCM) or swap execution facility (SEF).[12] The Rule, as currently drafted, applies much more broadly to any clearable derivative and not only to those traded on a DCM or SEF. Further, the standard form FIA-ISDA Cleared Derivatives Execution Agreement[13] gives the counterparties the option to treat the rejected trade as an uncleared bilateral transaction (which CMIC acknowledges should not be an option for a trade that is subject to the clearing requirement) or terminate the transaction and calculate an early termination amount pursuant to the terms of the 2002 ISDA Master Agreement. Various industry organizations are currently examining these provisions and related market conventions in light of the new mandatory swap execution facility rules in the US. Therefore, it is CMIC's view that the Rule and explanatory guidance should provide that only clearable derivatives traded on a SEF which are rejected by a clearing agency should be void *ab initio*, subject to allowing the trade to be re-submitted for clearing where the reasons for the initial rejection are operational or administrative. Otherwise, Canadian market participants could be offside evolving global market practice on this point. The consequences of rejection by a clearing agency of all other clearable derivatives should be determined by the parties to the trade or by the clearing agency.

Notice Regarding Determination

Section 13 of the Rule leaves it to the discretion of the applicable securities regulator as to whether a notice with respect to whether a derivative or a class of derivatives is clearable is published for comment. CMIC strongly believes that such notice should always be published for comment and that the comment period should be 60 days.

Form F1

Form F1 is required to be completed by parties relying on the intragroup exemption under section 8 of the Rule. Based on the information in the Rule and the explanatory guidance, it is not clear whether this form will be accessible by the public. CMIC recommends that this be clarified in the explanatory guidance.

Drafting: There is a typo in section 2.1 of Form F1 – the word "ground" should be "grounds".

[12] CFTC Staff Guidance on Swaps Straight-Through Processing, September 26, 2013 at p. 5. Available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/stpguidance.pdf.

[13] Version 1.1, published September 12, 2012, section 4. Available at: http://www.isda.org/publications/isda-clearedswap.aspx.

Form F2

One of the certifications on this form is that the clearing agency agrees to provide the local securities regulator with access to its books and records.[14] In CMIC's view, access should be limited to "applicable" books and records.

CONCLUSION

CMIC believes that continued engagement with the CSA is fundamental to the development of a regulatory framework that meets the G20 commitments and achieves the intended public policy purposes. Thoughtful inclusion by regulators of the points raised throughout this letter will meaningfully contribute to the success of the development of the final rules relating to mandatory central clearing.

As we have noted in our prior submissions, each subject relating to OTC derivatives regulation is interrelated with all other aspects. As such, CMIC reserves the right to make supplementary submissions relating to the Rule following publication of further consultation papers and model and draft rules.

CMIC hopes that its comments are useful in the development of rules relating to mandatory central clearing and that the CSA takes into account the practical implications for all market participants who will be subject to such rules. CMIC welcomes the opportunity to discuss this response with representatives from the CSA. The views expressed in this letter are the views of the following members of CMIC:

Bank of America Merrill Lynch
Bank of Montreal
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce
Deutsche Bank A.G., Canada Branch
Healthcare of Ontario Pension Plan
HSBC Bank Canada
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Royal Bank of Canada
The Bank of Nova Scotia
The Fédération des Caisses Desjardins du Québec
The Toronto-Dominion Bank

[14] We note that this is also a requirement under Section 2.1(2)(a) of Proposed OSC Rule 24-503 Clearing Agency Requirements.