March 19, 2014

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marches financiers
800, square Victoria, 22e etage
C.P. 246, tour de Ia Bourse
Montreal, Quebec
H4Z 1G3
consultation-en-cours@lautorite.qc.ca

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

Dear Mr. Stevenson and Me Beaudoin:

Please accept this letter as the comments offered by Custom House ULC, doing business as Western Union Business Solutions ("WUBS") on (i) Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "Central Counterparty Clearing Rule") and (ii) the Proposed Model Explanatory Guidance to Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "Central Counterparty Clearing EG" and, together with the Central Counterparty Clearing Rule, the "Proposed Model Rule"), submitted to you for forwarding to the Alberta Securities Commission, the Autorité des marches financiers, the British Columbia Securities Commission, the Manitoba Securities Commission, the Financial and Consumer Services Commission (New Brunswick), the Nova Scotia Securities Commission and the Ontario Securities Commission (collectively, the "Regulators").

WUBS is pleased to provide its comments on the Proposed Model Rule, and respond to the Regulators' requests for comments on the exemption from mandatory clearing for end-users outlined in CSA Staff Notice 91-303 (the "Notice").

We recognize that the Proposed Model Rule is part of a larger effort by the Regulators to adopt a uniform, comprehensive regime for the regulation of derivatives in Canada (the "Proposed Derivatives Regulations").

By way of background, WUBS operates a foreign exchange and cross-border payment service in Canada. WUBS is a registered money services business with the Financial Transactions and Reports Analysis Centre of Canada and the Autorité des marches financiers.. As part of its business, WUBS currently offers foreign exchange forwards and options, both of which products are or will be classified as derivatives in Canada under the Proposed Derivatives Regulations. WUBS' customer base is predominantly made up of commercial entities which have foreign exchange hedging needs in relation to foreign exchange payments or for balance sheet hedging purposes. WUBS' customer base is largely comprised of small- to medium-sized commercial parties which may use WUBS, as opposed to large commercial banks, to assist them with their hedging needs due to WUBS' industry-tailored payment solutions. In addition to its Canadian business, WUBS affiliates in the United States, Europe, Australia, Singapore, New Zealand and Hong Kong also deal in foreign exchange

forwards and/or foreign exchange options. WUBS is therefore familiar with the regulatory approaches taken in those jurisdictions with respect to many of the issues addressed by the Regulators under the Proposed Derivatives Regulations.

WUBS recognizes the global trend toward greater regulatory oversight of derivatives dealing, and its affiliates in the United States and Europe have implemented or are currently implementing many of the changes brought about by, respectively, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and the European Market Infrastructure Regulation ("EMIR"). We encourage the Regulators to ensure that their final rules on mandatory central counterparty clearing align the Canadian derivatives markets with other major markets and promote uniformity in regulatory oversight and market processes. We appreciate the opportunity to respond to the Regulators' requests for input from industry participants on the Proposed Model Rule.

Clearable Transactions

At present, no derivatives or classes of derivatives have been determined to be subject to the mandatory counterparty clearing requirement. We understand that these determinations will be made by the Regulators on a "bottom-up basis" relying in part on the information to be provided by clearing agencies in Form F2. Section 12 of the Central Counterparty Clearing Rule sets out a non-exhaustive list of factors that each Regulator will take into account in determining whether a derivative or class of derivative will be subject to the mandatory clearing obligation. Notable among these factors are "(j) the existence of a clearing obligation in other jurisdictions" and "(k) the public interest." We also note the CSA's stated intention in the Notice that to the greatest extent appropriate the determination process will be harmonized with international standards."

If this desire to ensure harmonization (as well as serve the public interest) is to be realized, we draw the Regulators' attention to the determination by the Secretary of the U.S. Department of the Treasury ("U.S. Treasury") on November 16, 2012[1] to exclude foreign exchange ("FX") swaps and FX forwards from the definition of "swap" under the U.S. Commodity Exchange Act ("CEA"), thereby rendering many of the requirements otherwise applicable to swaps under the CEA as amended by Dodd Frank, including mandatory clearing, inapplicable to FX swaps and FX forwards. We urge the Regulators to take a similar approach in this regard.

The U.S. Treasury's determination was strongly supported by many market participants in the United States who argued that applying clearing and trading requirements to FX swaps and FX forwards would increase costs, without providing sufficient offsetting regulatory benefits, and ultimately would have an adverse effect on U.S. business by discouraging hedging activity. The U.S. Treasury justified its determination by looking to, among other things, the following characteristics of the FX swaps and FX forwards markets:

- FX swaps and FX forwards trade in highly transparent and liquid markets, have fixed payment obligations, are physically settled and are predominantly short-term instruments;

- Settlement risk with respect to FX swaps and FX forwards is already addressed through the use of an efficient, well-functioning payment versus payment settlement system; and

[1] *See* Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 77 Fed. Reg. 69694 (November 20, 2012) *available at* http://www.gpo.gov/fdsys/pkg/FR-2012-11-20/pdf/2012-28319.pdf.

- FX swaps and FX forwards are subject to less counterparty credit risk than other swaps due to the shorter duration of the contracts.

We believe that the foregoing considerations are similarly applicable in the Canadian FX market and we urge the Regulators to determine in their final rules on mandatory central counterparty clearing that such clearing requirements will not extend to FX swaps and FX forwards. We believe that failure to do so would result in inconsistent regulation among the international FX markets, which could lead to market distortions and the possibility of regulatory arbitrage. For example, while an FX forward transaction between a U.S. company and a Canadian bank would not be subject to mandatory clearing under U.S. law, it may be subject to mandatory clearing under Canadian law. As Western Union conducts a global business, inconsistent regulation of FX markets between jurisdictions concerns us, as such inconsistencies substantially increase our costs, which costs will be incurred, at least in part, by our customers who will not receive any corresponding benefit. Further, the FX market is global and the imposition of clearing requirements in Canada that are absent in other jurisdictions could result in a migration of trading to other jurisdictions and result in a reduction in the liquidity available to Canadian counterparties, which will drive up costs for those counterparties. We do not believe these outcomes are in the Canadian public interest.

Paragraph (g) of the definition of Financial Entity

Paragraph (g) includes within the definition of "financial entity":

> *a person or company organized in a foreign jurisdiction that is analogous to any of the entities referred to in paragraphs (a) to (f) and would be regulated under the applicable legislation of Canada or* [applicable local jurisdiction].

We believe that the reach of paragraph (g) is far too broad and, given the current uncertainty regarding the circumstances in which an entity will be required to register as a derivatives dealer, too vague.

Paragraph (g)'s reference to paragraph (f) would, it appears, capture any entity anywhere in the world that might potentially be subject to registration as a derivatives dealer in Canada. The practical effect of this is that any such party transacting with a local counterparty that is itself a "financial entity" may be subject to mandatory clearing requirements in Canada regardless of whether the transaction is eligible for a clearing exemption in such party's own jurisdiction. For example, if a foreign affiliate of WUBS that could be characterized as a derivatives dealer in Canada were to propose to engage in an FX swap or FX forward with a Canadian bank, the Canadian clearing requirements could potentially apply even though such transaction would be exempt from clearing in that foreign affiliate's home jurisdiction. Moreover, imposing mandatory clearing on such a broad array of non-Canadian entities may discourage them from dealing with Canadian financial institutions (who would be unable to rely on the clearing exemptions in Section 7(1) of the Central Counterparty Clearing Rule for transactions with end-users), thereby reducing the volume of such institutions' FX trading activity and, in turn, reducing liquidity in the Canadian markets generally.

Commercial Risk

The exemption from mandatory clearing in Section 7(1) of the Central Counterparty Clearing Rule is limited to circumstances where the transaction serves to hedge or mitigate commercial risk. There are a number of examples where parties enter into FX transactions for non-investment/non-speculative

purposes which may not be characterized as a hedge for a "commercial risk of a business." We provide the following two examples:

(a) an individual in Canada enters into an agreement to purchase a house in the United States at a future date and hedges the risk of fluctuations in the USD/CAD exchange rate by entering into an FX forward; and

(b) an individual needing to provide funds to finance a foreign university education, with payments due at future dates, hedges the risk of fluctuation in exchange rates by entering into an FX forward.

The risk of exchange rate fluctuations in the context of buying a home abroad or financing an education may not be seen as a "commercial risk of a business," even though an individual in Canada is legitimately seeking to hedge against the risk of loss on a financial transaction due to fluctuations in currency. Under a too narrow interpretation of 7(1), such a transaction might not qualify under the proposed Section 7(1) exemption.

We do not believe that it was the Regulators' intention to impose clearing requirements on transactions of this nature and believe the public interest would be best served if the Proposed Central Counterparty Rule were modified to allow any person hedging a financial transaction against currency fluctuations to qualify under the proposed exemption. In this regard, we also believe an explanation similar to the one provided in Part 3(h) of Companion Policy 91-506CP would be helpful.

* * *

WUBS thanks you for the opportunity to provide our input on the Proposed Model Rule and looks forward to the publication of final rules.

Sincerely,

John Jones
Assistant Secretary