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Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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Dear Sirs/Mesdames:

RE: Comment Letter to CSA Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the "Proposed Clearing Rule") and Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives* (the "Proposed Clearing CP")

The International Energy Credit Association **("IECA")** hereby submits the comments contained in this letter on behalf of its members in response to the solicitation for comments made by the Canadian Securities Administrators' (**"CSA"**) OTC Derivatives Committee (the **"Committee"**) in respect of the following published documents:

- The Proposed CSA National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the "**Proposed Clearing Rule**"); and

- The Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives* (the "**Proposed Clearing CP**")

I. Introduction

The IECA is not a lobbying group. Rather, we are an association of several hundred energy company credit management professionals grappling with credit-related issues in the energy industry.

The IECA seeks to protect the rights and advance the interests of the commercial end user community that makes up its membership. IECA membership includes many small to large energy companies, few of whom would be deemed to be derivatives dealers in Canada, but all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that Canadian businesses and consumers require for our economy and our livelihood.

Correspondence with respect to this comment letter and questions should be directed to the following individuals:

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The IECA thanks the Committee for considering and making changes based on, public comments to the CSA Notice 91-303 Proposed Model Provincial Rule on Mandatory Counterparty Clearing of Derivatives (the "**Draft Model Rule**"), which the CSA published on December 19, 2013, and which is the basis for the Proposed Clearing Rule. In particular, the IECA commends the CSA for the following changes from the Draft Model Rule to the Proposed Clearing Rule: (i) developing a national instrument, rather than province-specific model provincial rules, with respect to mandatory clearing of derivatives, which would create a uniform Clearing Rule across Canada; (ii) removing the requirement for market participants to obtain board approval to qualify for the end-user exemption; (iii) allowing counterparties to rely on representations made to each other in determining whether clearing exemptions are available; (iv) providing clarifications with respect to completing and filing proposed Form F1; and (v) proposing a phased-in approach with respect to the clearing requirement. Despite these and other positive changes however, the IECA still has concerns about the provisions of the Proposed Clearing Rule and offers the following specific comments below for the CSA's further consideration.

II. Specific Comments

1. Definition of "financial entity

The IECA notes that the definition of a "*financial entity*", in sub-section 1(e) of the Proposed Clearing Rule, includes persons or companies that are either: (i) subject to a registration requirement; (ii) registered; or (iii) exempt from the registration requirement, under securities legislation of a Canadian jurisdiction. The IECA respectfully asks the Committee to clarify how derivatives market participants are supposed to determine if they fall under one of the registration elements, in the financial entity definition, unless or until the CSA has finalized rules with respect to derivatives markets participant registration?

The IECA notes that, in response to comments about the registration issue at page 11 of the CSA's covering notice document to the Proposed Clearing Rule, the Committee states that it believes that the proposed phase-in approach to the clearing requirement under the Proposed Clearing Rule will allow provincial regulators time to clarify the developing registration regime. Although the IECA fully supports a phased-in approach to the clearing requirement and agrees that more clarity is required about the registration regime, the IECA submits that the clearing requirement should not become effective at all until, or unless, the registration regime is finalized. If per chance the registration regime is not finalized before the first clearing requirement becomes effective under the proposed phase-in approach, how would the Committee suggest that market participants determine their status as "financial entities" or not under the registration elements within that definition? The IECA respectfully submits that such determination is impossible unless, or until, the registration requirements are finalized.

2. Definition of "local counterparty"

With respect to sub-paragraph (b) of the "local counterparty" definition in Section 1 of the Proposed Clearing Rule, the IECA requests that the Committee please clarify what it intends the words *"...is responsible for the liabilities of the counterparty;"* to mean? In particular, does the Committee intend those words to mean responsible for: (i) all of such affiliated entity's liabilities of any kind whatsoever; (ii) just liabilities with respect to derivatives trades; (iii) liabilities on a trade by trade, or counterparty by counterparty basis; or (iv) some other meaning?

In addition, the IECA notes that derivatives regulators in the United States and the European Union have adopted mandatory clearing requirements that may extend to entities organized outside of the U.S. or the EU (e.g. Canada), but whose head-offices or principal places of business may be in the U.S. or the EU. Similarly, the definition of *"local counterparty"* in the Proposed Clearing Rule appears to capture entities that may be organized in a third country (e.g., the United States or the EU), but that have their "head office" or "principal place of business" in a Canadian "local jurisdiction." The IECA requests that the Committee please clarify if they intended such potential extra-territorial reach within the definition of "*local counterparty*" or not? If extra-territorial application was intended, the IECA further requests that the Committee please clarify how derivatives market participants are to interpret the words "head office" and/or "principal place of business"? Should market participants rely on common law definitions of those terms or did the Committee intend the terms to have some other specific meaning and if so, what meaning?

To the extent that any Canadian definitions (common law and/or statutory) of "head office" and/or "principal place of business" differ materially from the approaches taken by the U.S. and the EU with

respect to mandatory clearing, the IECA urges the Committee to adopt meanings for those terms that are harmonized with the U.S. and EU approaches. For example, entities that have already determined the location of their head offices and/or principal places of business under the U.S. and/or EU clearing rules should not have to re-evaluate those issues under materially different definitions in Canada to potentially arrive at a different result with respect to whether or not they would be a "local counterparty" under the Proposed Clearing Rule.

The IECA believes that clear, harmonized definitions and approaches are important for regulatory consistency, facilitating compliance and preventing regulatory arbitrage, particularly across the G-20 jurisdictions. To that end, the IECA urges the Committee to craft the Proposed Clearing Rule (and indeed all CSA proposed derivatives rules) in such a way as to maximize inter-jurisdictional recognition, harmonization and substituted compliance among the G-20.

3. Interpretation of hedging or mitigating commercial risk

The IECA commends the Committee for revising the interpretation of "*hedging or mitigating commercial risk*", found in sub-section 4(1) of the Proposed Clearing Rule, from the definition that was found in the Draft Model Rule, in particular the deletion of the "closely correlated" and "highly effective" language that was vague and confusing. We also find the revised explanatory guidance on this point in the Proposed Clearing CP to be helpful.

The IECA requests however that the Committee please provide additional guidance with respect to its understanding of the phrase *"... intended to reduce risk..."* in sub-section 4(1). The IECA submits that the word "*intended*" is very subjective and should be clarified. In particular, we ask that the Committee please clarify by what evidence or criteria the apparent "intent" requirement within that sub-section would be satisfied? In other words, how is a derivatives market participant supposed to demonstrate that it has satisfied the requisite intent for the purposes of its derivatives transactions being considered as being for the purposes of hedging or mitigating commercial risk?

The IECA recognizes that the concept of "*intended to reduce risk*", in the context of the derivatives trading activities of market participants, may mean very different things to different market participants. The IECA and its members would be very happy to discuss this concept with the Committee by telephone or through in person meetings.

4. "Speculate" should be defined or clarified

The IECA requests that the Committee either define, or further clarify, what it considers the term "speculate" to mean for the purposes of the Proposed Clearing Rule? Because derivative positions held for speculation may not benefit from any of the exemptions to mandatory clearing contained in the Proposed Clearing Rule, the IECA submits that "speculate" needs to be clearly defined so that market participants can properly comply with the clearing requirement. The IECA suggests that a reasonable definition of "speculate" could be framed in terms of derivatives trading activity that does not have a direct or indirect connection to hedging or mitigating commercial risks faced by the party engaged in such trading, but is solely entered into for the purposes of investing for potential gain or potentially generating profit.

5. Duty to submit for clearing

In connection with the duty to submit a transaction in a mandatory clearable derivative for clearing pursuant to Section 5 of the Proposed Clearing Rule, the IECA would like to reiterate its earlier comments about the importance of harmonization, inter-jurisdictional recognition and substituted compliance among the G-20 and within Canada. The IECA believes it is critically important to effective compliance and regulatory oversight that inter-provincially and internationally harmonized criteria be applied to the determination of when a derivative transaction would be mandated for clearing and which counterparty would have the duty to submit such transaction for clearing.

6. Crown Corporations Exemption Section 6

The IECA strongly disagrees with the exemption from the clearing requirement that is made available to Crown corporations, or entities whose obligations are guaranteed by the federal or provincial governments, under Section 6 of the Proposed Clearing Rule. The IECA submits that such exemption will give such entities a significant competitive advantage over non-Crown entities that will be required to comply with the clearing mandate because of the increased transaction and compliance costs that the clearing mandate will undoubtedly bring to derivatives market participants. Some IECA members transact derivatives with the types of Crown entities that would benefit from the proposed exemption. In our members' experience such Crown entities are often large and sophisticated Canadian derivatives market participants. The IECA respectfully submits that such entities do not need competitive advantages handed to them by the CSA through a derivatives regulatory regime to the detriment of other market participants.

To better ensure transparency and a "level playing field" in derivatives markets the IECA submits that all derivatives market participants should be subject to the same requirements with respect to mandatory clearing, or exemptions from it, and special treatment should not be afforded to one particular class of market participant to the potential detriment of other classes. Alternatively, if special treatment is to be given to particular classes of derivatives market participants, that treatment should be based on objective criteria, such as credit rating metrics, market capitalization, derivatives portfolio size, etc., that are evenly applied to all market participants.

The IECA notes the Committee's comments in connection with this issue at pages 19-20 of the covering notice to the Proposed Clearing Rule, namely that provincial regulators may at some point in the future modify the applicability of all exemptions, including the Crown corporation clearing exemption. In response to those comments, the IECA respectfully submits that (i) now is the time for the CSA to get these rules right, rather than deferring to potential future action by provincial regulators, and (ii) to the utmost extent possible the rules should be consistent across Canada, rather than different from province to province. Leaving this issue to potentially be addressed and modified by provincial regulators at some future date appears to undermine the rationale for the Committee adopting a National Instrument approach for the Proposed Clearing Rule in the first place.

A further concern that the IECA has with the language in section 6 is the potential availability of a clearing exemption to foreign governments and entities owned and controlled by foreign governments under sub-section 6(a). With utmost respect, the IECA submits that providing a clearing exemption, *ab initio* and without further qualifying criteria, to foreign governments and their commercial entities to be patently arbitrary, unreasonable and unjustifiable. The Committee appears to have assumed that just because a

derivatives market participant is either a foreign government, or a commercial entity of a foreign government, that market participant's derivatives trading activities would pose no systemic risk to Canada's financial system.

The IECA would respectfully point out to the Committee that many foreign governments, and by extension their commercial entities, have extremely poor credit ratings. Additionally, such governments may have regulations and case law in their respective countries that undermine the ability of guarantees to be enforced against companies, owned by the foreign governments, by entities outside their jurisdiction. As a result participation in the Canadian derivatives markets by such foreign governments and/or their commercial entities could indeed pose serious systemic risk to those markets. The IECA strongly urges the Committee to reconsider and remove the non-application of the clearing requirement to foreign governments and their commercial entities unless such governments and entities can demonstrate that (i) they satisfy certain objective and quantifiable financial metrics, such as credit ratings, and (ii) their Canadian derivatives trading activities do not in fact pose systemic risk within Canada.

7. End-User Exemption-Section 9

The IECA respectfully submits that sub-paragraph 9(2)(c) of the Proposed Clearing Rule should be deleted in its entirety because it is illogical and unnecessary. The provisions in sub-paragraphs 9(2)(a) and (b) are adequate to ensure that the end-user clearing exemption is not abused. We believe that 9(2)(c) is illogical and unnecessary because the status of the "affiliated entity", referred to in that sub-paragraph, as a "financial entity" or not should be irrelevant to the issue of whether the end-user exemption should be available or not to the affiliated counterparty on whose behalf the affiliated entity is acting with respect to derivatives transactions. The germane question should be whether the affiliated counterparty itself is, or isn't, an end-user. If it is an end-user then why should it matter whether or not its derivatives trading affiliate, that is merely acting as a disclosed or undisclosed agent, is itself an end-user or not? The agent's status should be irrelevant to determining whether the principal is an end-user or not and therefore whether the end-user clearing exemption is available to it or not.

8. Intragroup Exemption Section 10

With respect to sub-paragraph 10(2)(a) of the "Intragroup exemption", the IECA respectfully requests that the Committee clarify that the "*agreement*" between affiliated counterparties to rely on the intragroup clearing exemption, referred to in that sub-paragraph, need not be a written agreement on a transaction by transaction basis. The IECA submits that requiring that level of agreement specificity would be both extremely onerous on market participants and do little to address systemic risk. Instead, the IECA submits that the "agreement" requirement in sub-paragraph 10(2)(a) should be considered satisfied as long as the two affiliates have written documentation between them, for example, either an express agreement or joint policies and procedures, that address the circumstances under which they will rely on the intragroup clearing exemption for derivative trades between them that qualify for the intragroup exemption.

With respect to the requirement for "*... a written agreement setting out the terms of the transaction between the [affiliated] counterparties*" in sub-paragraph 10(2)(c), the IECA ask that the Committee please clarify that the requirement would be satisfied by there being one or more written master forms of agreements in place between the affiliated counterparties, under which they are enabled to enter into specific derivative

transactions, but that there need not be written confirmations for each such specific transaction. The IECA submits that requiring written confirmations on a trade by trade basis for affiliated counterparties whose financial statements are prepared on a consolidated basis is unnecessary, overly onerous and does not contribute to reducing systemic risk.

9. Record Keeping under Section 11

In connection with the record keeping requirements in section 11 of the Proposed Clearing Rule, and the associated explanatory guidance at page 42 of the Proposed Clearing CP, in particular the commentary about "*...reasonable supporting documentation should be kept for each transaction where the end-user exemption is relied upon...*", the IECA respectfully submits that the requirement to keep the kinds of documentation enumerated on page 42 on a transaction by transaction basis is unreasonably onerous and unnecessary. Rather, the IECA submits that keeping such documentation on a portfolio wide basis should suffice.

The Committee has rightly recognized, in the commentary on page 42, that hedging strategies or programs are typically at a macro or portfolio level. Accordingly, documentation of such strategies or programs would also typically be at macro or portfolio levels and not necessarily at the granularity of specific transactions. The IECA respectfully submits that the objective of addressing systemic risk would be adequately addressed by requiring derivatives market participants to keep, and if required to produce, portfolio wide documentation to evidence that their hedging strategies satisfy the requirements of the end-user, intragroup and/or any other exemptions that are or may become available to mandatory clearing under the Proposed Clearing Rule.

10. Including a "Treasury Affiliate" Exemption

The IECA thanks the Committee for including the end-user and intragroup exemptions at sections 9 and 10 of the Proposed Clearing Rule. The IECA believes that those exemptions will benefit many market participants while at the same time not undermining the important goal of reducing systemic risk. In the interests of international regulatory harmony and consistency, particularly as between Canada and the United States, the IECA also urges the Committee to consider and adopt an exemption similar to what the CFTC in the U.S. has coined as the "treasury affiliate exemption" to mandatory clearing through no-action relief.

The CFTC published CFTC Letter No. 14-144[1] ("**Letter 14-144**") on November 26, 2014. Letter 14-144 amended and restated the CFTC's earlier No-Action letter 13-22[2] ("**Letter 13-22**") published on June 4, 2013. Letter 14-144 removed or amended several of the restrictive conditions on the relief from mandatory clearing provided to certain "treasury affiliates" by Letter 13-22. The industry had commented on the impracticality of several of the conditions of Letter 13-22, and the CFTC responded to these comments by modifying certain conditions to make the relief available to a broader spectrum of market participants acting as treasury affiliates. As in Letter 13-22, the treasury affiliate exemption in Letter 14-144 allows treasury affiliates undertaking hedging activities on behalf of non-financial affiliates within a corporate group to elect the end-user exception from mandatory clearing even if such treasury affiliates are not acting

[1] http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-144.pdf
[2] http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-22.pdf

as agents of their non-treasury affiliates. As stated above, the IECA respectfully urges the CSA to adopt a clearing exemption similar to the treasury affiliate exemption adopted by the CFTC.

11. Exemptions under Section 13 and Compliance Phase-in

The IECA notes that under section 13 of the Proposed Clearing Rule it is contemplated that provincial securities regulators may grant exemptions to the Proposed Clearing Rule *"...in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption."* Although the IECA recognizes that the discretion to grant exemptions lies with provincial securities regulators, for the sake of consistency across Canada, the IECA submits that the Proposed Clearing Rule should, at a minimum, provide uniform guidelines and/or a harmonized process under which market participants could apply for and obtain exemptions. In particular, to the extent that exemptive relief application processes, and the criteria under which relief may be granted, may be more or less onerous across various Canadian jurisdictions, the IECA respectfully submits that the CSA should attempt to harmonize disparate provincial application process and relief criteria to the greatest extent possible, in light of the different securities legislative regimes across Canada. Having harmonized exemptive relief processes and criteria would greatly facilitate ease of compliance by market participants and discourage regulatory arbitrage.

As a further point with respect to exemptive relief applications under section 13 and in connection with the proposed phase-in periods for compliance with the clearing mandate, set forth in Appendix A of the Proposed Clearing Rule, the IECA asks that the Committee please clarify that the clearing mandate would not begin, or continue to apply to, a market participant during the pendency of any exemptive relief application under section 13? For example, if a market participant has made an application to its local provincial securities regulator for exemptive relief from all or part of the clearing mandate and the start date, to be set forth in Appendix A, for mandatory clearing has begun for such market participant and/or a particular class of derivatives, then, with respect to that market participant the clearing requirement should be held in abeyance until the exemptive relief application has been finally determined by the relevant securities regulator? The IECA respectfully submits that such abeyance pending the outcome of the exemptive relief application is both just and logical and asks the Committee to please clarify, either in the Proposed Clearing Rule or the Proposed Clearing CP, whether it agrees with this submission or not?

III. Conclusion

The IECA appreciates the opportunity to table our members' comments and concerns to the Authorities. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member.

Yours truly,

INTERNATIONAL ENERGY CREDIT ASSOCIATION

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