

May 13, 2015

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

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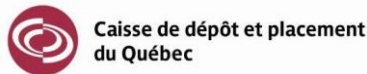
Josée Turcotte, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Re: Proposed NI 94-101 and Proposed Companion Policy 94-101CP (the “Proposed National Instrument”) *Mandatory Central Counterparty Clearing of Derivatives*

Dear Sirs and Madams,

The undersigned Canadian public sector pension fund managers, administrators and/or trustees, British Columbia Investment Management Corporation, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Healthcare of Ontario Pension Plan Trust Fund, OMERS Administration Corporation, Ontario Teachers’ Pension Plan, and Public Sector Pension Investment Board (collectively “Canadian Pension Fund Managers,” “we” or “our”),¹ are grateful to have the opportunity to provide comments on the Proposed National Instrument.

¹ Please refer to Appendix 2 for a detailed description of each Canadian Pension Fund Manager.



Our group represents many of the largest Canadian pension fund managers. We have common features and objectives, including that of maximizing the returns for our beneficiaries while satisfying our fiduciary duties. On an aggregate basis, we manage approximately \$960 billion in assets.

We support the Canadian Securities Administrators' efforts to improve transparency in the derivatives market and enhance the mitigation of systemic risk with the Proposed National Instrument; however, we do not believe that (i) extending mandatory clearing rules to the Canadian Pension Fund Managers, and (ii) including pension funds under the definition of "financial entity" in the Proposed National Instrument, serves to achieve this objective. We believe that Canadian regulators should follow the approach of similar jurisdictions such as Australia and Japan in excluding unlevered asset managers, pension funds and other non-dealers from the mandatory central clearing requirement, given that such entities do not pose a systemic risk to financial markets.

Many of the Canadian Pension Fund Managers have also been involved in commenting on the Proposed National Instrument through the Canadian Market Infrastructure Committee ("CMIC") and the Pension Investment Association of Canada ("PIAC"), and those who are not members of CMIC have been provided with CMIC's comment paper, and support the comments contained within both CMIC and PIAC's responses. Our comments in this letter highlight our concerns with respect to the application of the Proposed National Instrument to Canadian Pension Fund Managers, noting that the other comment papers did not focus on exempting large Canadian pension fund managers from the mandatory clearing requirements.

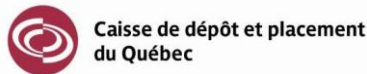
APPLICABILITY

We believe that the Australian and Japanese regulations on central clearing provide a useful model for Canada, given that they have similar financial markets. In Australia, non-dealers are exempted from mandatory central clearing requirements, based on regulatory findings that non-dealer activity in OTC derivatives is relatively limited, and thus the systemic risk reduction benefit from including them is likely to be limited.²

Similarly, the Japanese regulations on central clearing only apply to large domestic financial institutions registered under the Financial Instruments and Exchange Act ("FIEA") that are defined as "Financial Institution Business Operators" or "Registered Financial Institutions" and are members of licensed Japanese clearinghouses. Thus, in practical terms the clearing regime in Japan only applies to dealer-to-dealer transactions.³

² Australian Prudential Regulation Authority, Australian Securities and Investment Commission and Reserve Bank of Australia, *Report on the Australian OTC Derivatives Market*, April 2014, p. 3. Accessed at: <http://www.cfr.gov.au/publications/cfr-publications/2014/report-on-the-australian-otc-derivatives-market-april/pdf/report.pdf>.

³ Thomas Treadwell, "OTC Clearing in Japan: Solid Start for Interest Rate Swaps," *Futures Industry Magazine*, January 2013, p. 42. Accessed at: <https://secure.fia.org/files/css/magazineArticles/article-1534.pdf>.



We believe that Canadian regulators should take a similar approach, in that the proposed mandatory clearing regime should only apply to large Canadian financial institutions that are considered dealers in OTC derivatives, where applicable.

SYSTEMIC RISK

In our opinion, the Canadian Pension Fund Managers do not pose a systemic risk to the financial markets and, as such, should be excluded from the scope of mandatory clearing. To reiterate some of the comments submitted by PIAC, we highlight the following fundamental characteristics of Canadian pension funds:

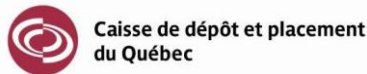
- Canadian pension funds, regardless of size, use derivatives for a variety of investment objectives, including for certain pension funds to hedge foreign exchange risks associated with investments in foreign jurisdictions, given that our pension benefit obligations have to be paid out in Canadian dollars.
- Canadian pension funds are generally very creditworthy counterparties with long-term investment horizons.
- Canadian pension funds, regardless of size, are not highly leveraged, do not rely heavily on short-term financing, and are not subject to redemptions; all key characteristics of market participants that pose systemic risk.
- Canadian pension funds may in fact be viewed as reducing systemic risk and increasing liquidity in derivatives markets.

The aforementioned characteristics were noted by Mr. Lawrence Schembri, Deputy Governor of the Bank of Canada in a speech to PIAC in Quebec City on May 15, 2014, when he stated the following:

pension funds can more easily bear market and liquidity risk...because they can diversify these risks over time. Their long investment horizons are different from those of most other market participants, who are more focused on short-term returns. Thus pension funds have the capacity to smooth and absorb short-term volatility and act as a net provider of liquidity and collateral to the system, especially in times of stress...Pension funds do not rely primarily on borrowing to fund their investments, and are not vulnerable to excessive leverage or significant liquidity and maturity mismatches...Hence, they are, in general, not a source of systemic risk to the financial system.⁴

These characteristics were also observed by the Financial Stability Board (“FSB”) and International Organization of Securities Commissions (“IOSCO”) in their second consultative document “Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important

⁴ See Remarks by Lawrence Schembri, Deputy Governor to PIAC in Quebec City, May 15, 2014, available at: <http://www.bankofcanada.ca/2014/05/double-coincidence-needs-pension-funds/>



Financial Institutions: Proposed High-Level Framework and Specific Methodologies,” dated March 4, 2015,⁵ in which FSB and IOSCO have sought to establish methodologies aimed at identifying non-bank, non-insurer financial institutions “whose distress or disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the wider financial system and economic activity at a global level.”⁶ In their consultation paper, FSB and IOSCO asked if pension funds should be excluded from the scope of being considered systemically important, in which they stated that one argument is that pension funds “pose low risk to global financial stability and the wider economy due to their long-term investment perspective”.⁷

Australian regulators came to a similar conclusion in their *Report on the Australian Derivatives Market*, which states:

the Regulators are not convinced of the public policy case for introducing mandatory central clearing of OTC derivatives for non-dealers With few exceptions, non-dealers’ activity in OTC derivatives is relatively limited and motivated primarily by hedging of underlying cash flows and exposures. Accordingly, even though there may be some systemic risk reduction benefit from central clearing by non-dealers, it is likely to be limited. Indeed, where small financial institutions and especially non-financial entities have restricted access to liquid assets to meet CCPs’ initial and variation margin obligations, new sources of risk could emerge.⁸

Additionally, we would like to note that many of the Canadian Pension Fund Managers are already subject to extensive legislation under the federal and provincial governments and are registered with various regulatory bodies, including, for example, the Financial Services Commission of Ontario and the Office of the Superintendent of Financial Institutions Canada. As a result of these regulations we have developed sophisticated investment processes and have extensive risk management systems in place, as outlined in Appendix 1.⁹

For the reasons listed above, it is our opinion that the Canadian Pension Fund Managers, do not pose a systemic risk to the financial markets. Accordingly, such entities should be excluded from the scope of mandatory clearing or should not be included as “financial entities” under the Proposed National Instrument. We are of the view that the G-20 intent behind mandatory clearing was to

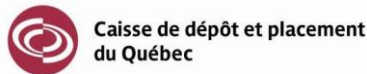
⁵ Accessed at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD479.pdf>.

⁶ Ibid, p. 1.

⁷ Ibid, p. 5

⁸ *Report on the Australian OTC Derivatives Market*, p. 47.

⁹ This list was taken from Exhibit B of the Global Pension Coalition’s (comprised of the American Benefits Counsel, The Committee on Investment Employee Benefit Assets, Pensions Europe, The European Association of Paritarian Institutions, The National Coordinating Committee for Multiemployer Plans, and The Pension Investment Association of Canada) comment paper: “Comments on Second Consultative Document: Margin Requirements for non-centrally cleared derivatives, issued by the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions,” dated March 15, 2013.



mitigate systemic risk, and as the Canadian Pension Fund Managers do not pose a systemic risk to the financial markets, we should not be subject to a Canadian mandatory clearing requirement.

COUNTERPARTY RISK

In our opinion, mandatory clearing requirements could increase our counterparty risk. In a July 2013 survey conducted by Australian regulators¹⁰ to determine the incremental costs and benefits of extending any central clearing mandate to non-dealers, the following observations were made with regards to counterparty risk management for non-dealers:

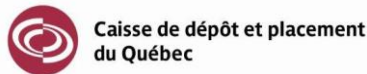
Non-dealer [survey] respondents reported the creditworthiness of their counterparty as one of the most important factors when trading OTC derivatives. All non-dealer respondents managed the credit risk to bilateral counterparties by applying credit limits and diversifying their exposure across counterparties.”¹¹

We believe that these findings are largely applicable to Canadian pension funds and other non-dealers in the Canadian OTC derivatives market. Generally, the Canadian Pension Fund Managers only enter into OTC derivatives transactions with highly rated counterparties in Canada, the United States, Europe, and to a lesser extent, Asia, Australia and other global jurisdictions, while diversifying our exposure amongst these counterparties. In each case, we have International Swaps and Derivatives Association (“ISDA”) Master Agreements and Credit Support Annexes (“CSAs”) in place, and we accordingly have collateral mechanisms in place to mitigate counterparty credit risk. As such, we do not believe that the Canadian Pension Fund Managers pose significant counterparty risk, and moreover, as we are holding liquid collateral from counterparties, we already have sufficient risk measures in place in the event of the default of a counterparty. Further supporting reasons for this viewpoint are provided in Appendix 1.

We would stress that mandating central clearing does not eliminate counterparty risk to Canadian Pension Fund Managers. Instead, it concentrates the risk in the form of futures contract merchants (“FCMs”) or clearer default risk. The Canadian Pension Fund Managers are generally of a higher credit standing than our OTC derivatives counterparties, as well as our FCMs/ clearers. It is accordingly important that the Canadian Pension Fund Managers reduce our risk to such counterparties by broadly diversifying our OTC derivatives transactions across multiple counterparties and jurisdictions. If Canadian regulators require mandatory clearing to apply to the Canadian Pension Fund Managers, then in respect of those cleared products, our diversification would be greatly decreased. For cleared derivatives products we continue to face over-collateralization risk should our FCM or clearer face bankruptcy protection. We believe our over-collateralization risk is mitigated if we are facing a much greater number of ISDA counterparties as compared to a much smaller number of FCMs/ clearers.

¹⁰ Including the Australian Prudential Regulation Authority, the Australian Securities and Investment Commission and the Reserve Bank of Australia.

¹¹ *Report on the Australian OTC Derivatives Market*, p. 41.



Moreover, the Canadian Pension Fund Managers regard the Canadian bank OTC counterparties to be amongst the most financially sound of counterparties. If Canadian Pension Fund Managers were forced to clear OTC products executed with Canadian banking counterparties, we would likely be shifting our risks from Canada to some of the larger US based FCMs or European clearers, who might be of lower credit quality than our Canadian OTC banking counterparties. Such migration to US FCMs and European clearers would result in a decrease of Canadian collateral which we may post, which has the potential to impact the liquidity of such Canadian securities (Canadian federal and provincial bonds) and markets. Moreover, it will introduce FX risk in entering into Canadian derivatives transactions. For example, an interest rate swap between a Canadian pension fund manager and a Canadian bank would have to clear through a US or European central clearing party with both parties likely to post non-Canadian cash as variation margin, resulting in FX risks.

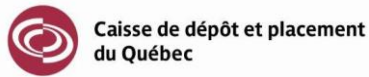
CASH COLLATERAL

Imposing mandatory clearing will obligate the Canadian Pension Fund Managers to post additional cash collateral, which will reduce long-term returns for our beneficiaries. Currently, Canadian Pension Fund Managers are permitted to post high-quality government bonds as variation margin under our ISDA CSA agreements. If we were mandated to centrally clear our OTC derivative transactions, we would be forced to post only cash collateral as variation margin. This would lead to a reduction in the long-term returns for our plan beneficiaries, given that we would be forced to hold a greater percentage of our assets in cash, on which we are unable to make a material return. Moreover, a requirement to post a greater percentage of assets in cash would potentially increase our overall funding risks. In contrast, the ability to post high-quality government bonds as variation margin (as is the case under our CSAs) supports portfolio diversification, our liability-driven investing strategies and our long-term return objectives.

Moreover, central clearing parties have concentration limits in terms of which types of government bonds they are able to accept as initial margin. Such restrictions would limit the types of collateral that Canadian Pension Fund Managers would be able to post as initial margin. For instance, Canadian government bonds are considered a Category 4 collateral type by the CME.¹² As such, the amount of Canadian government bonds that may be posted to the CME per clearing member is capped (notably, provincial government bonds are not included under this category). Moreover, the cap is applied at the clearing member firm level; therefore, if one of the Canadian Pension Fund Managers causes this cap to be reached, another Canadian Pension Fund Manager will not be permitted to post this type of collateral.

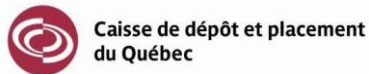
For the abovementioned reasons, it is our opinion that the mandatory clearing requirements outlined in the Proposed National Instrument should not apply to the Canadian Pension Fund Managers. Rather, the approach taken to mandatory clearing in Australia and Japan should be adopted in Canada whereby only large Canadian financial institutions that are considered dealers in OTC derivatives are required to clear mandated derivatives, where applicable.

¹² See <http://www.cmegroup.com/clearing/financial-and-collateral-management/#foreignSovDebt>



We thank you for your consideration of our views.

British Columbia Investment Management Corporation
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Healthcare of Ontario Pension Plan Trust Fund
OMERS Administration Corporation
Ontario Teachers' Pension Plan
Public Sector Pension Investment Board



APPENDIX 1

The following is the complete text of Exhibit B to the Global Pension Coalition Margin Paper¹³ and applies to Canadian Pension Fund Managers that are subject to the Pension Benefits Act:

Below is a summary of some of the key reasons Canadian plans present virtually no counterparty risk. Note that Canadian pension funds may be regulated by provincial or federal laws and regulations, so certain of the factors below may not apply to all pension plans.

- Pension plans are subject to a prudent portfolio investment standard. For example, the administrators of pension plans subject to the laws of Ontario are required to “exercise the care, diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.”¹⁴ In doing so, the administrator must use all relevant knowledge and skill that it possesses, or ought to possess, in the administration and investment of the pension fund.¹⁵
- Pension plans are subject to investment restrictions, concentration limits and other restrictions mandated by law.
- Pension plans must establish and file with the appropriate regulators a detailed statement of investment policies and procedures, including with respect to the use of derivatives, options and futures.¹⁶ Such document outlines the plans expectations with respect to diversification, asset mix, expected returns and other factors.
- Administrators of pension funds are subject to strict prohibitions concerning conflicts of interest. Similar prohibitions are also imposed on employees and agents of the administrator.¹⁷
- Pension plans are generally prohibited from borrowing.¹⁸
- The assets of pension plans are held in trust by licensed trust companies or other financial institutions and are separate from the assets of their sponsors.
- Funding shortfalls may be funded by the pension plan’s corporate or government sponsor, by increasing contributions of pensioners or by lowering benefit payments, depending on the nature of the plan.
- Pension plans must regularly file an actuarial valuation with the appropriate regulators.

¹³ Supra, note 9.

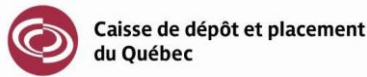
¹⁴ E.g., Pension Benefits Act, RSO 1990, c P.8 (“PBA”), s 22(1).

¹⁵ E.g., PBA s 22(2).

¹⁶ Pension Benefits Standards Regulations, 1985, SOR/87-19, s 7.1.

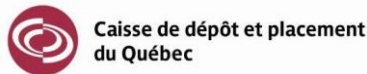
¹⁷ E.G., PBA ss22(4) and 22(8).

¹⁸ Income Tax Regulations, CRC c 945, s 8502(i).



- Pension plans are transparent to members and regulators. Provincial legislation requires that pension plans file a detailed annual financial statement accompanied by an auditor's report.¹⁹
- Pension plans are not operating entities subject to business-line risks and competitive challenges.
- The governance of Canadian pension plans is subject to statutory requirements and guided by best practices.
- There is no provision under any Canadian law for pension plans to file for bankruptcy or reorganization to avoid their financial obligations to counterparties or other creditors. Additionally, the voluntary termination of a plan does not relieve the plan of its financial obligations.”

¹⁹ E.g., Pension Benefits Act, RRO 1990, Reg 909, s 76. In addition, an auditor's report is required for pension plans with \$3 million or more in assets.



APPENDIX 2

DESCRIPTION OF CANADIAN PENSION FUND MANAGERS

BRITISH COLUMBIA INVESTMENT MANAGEMENT CORPORATION

With a global portfolio of more than \$114.0 billion, British Columbia Investment Management Corporation (“bcIMC”) is one of Canada’s largest institutional investors within the capital markets. bcIMC invests on behalf of public sector clients in British Columbia. bcIMC’s activities help finance the retirement benefits of more than 522,000 plan members, as well as the insurance and benefit funds that cover over 2.2 million workers in British Columbia.

Based in Victoria, British Columbia and supported by industry-leading expertise, bcIMC offers its public sector clients responsible investment options across a range of asset classes: fixed income; mortgages; public and private equity; real estate; infrastructure; renewable resources; long-term strategic themes. bcIMC’s investments provide the returns that secure its clients’ future payments and obligations.

CAISSE DE DÉPÔT ET PLACEMENT DU QUÉBEC

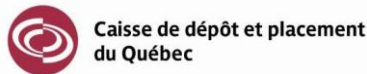
The Caisse de dépôt et placement du Québec (“CDPQ”) is a mandatory of the Province of Québec. It manages institutional funds, primarily from public and private pension and insurance funds in Québec. CDPQ’s mission is to achieve an optimal return on the deposits of its clients, or depositors, while contributing to the Québec’s economic development. It invests in financial markets in Québec, elsewhere in Canada, and around the world, in various types of assets, and in all economic sectors. Through its size and activities, the Caisse is a global investor and one of the largest institutional fund managers in Canada and North America as a whole. It is one of the largest institutional investors in Canada and, as at December 31, 2014, its depositors’ net assets totaled \$225.9 billion.

CANADA PENSION PLAN INVESTMENT BOARD

The CPP Investment Board is a professional investment management organization based in Toronto that was established by an Act of Parliament in December 1997. Our purpose is to invest the assets of the Canada Pension Plan in a way that maximizes returns without undue risk of loss. The CPP Investment Board has more than \$238.8 billion net assets as of December 31, 2014.

HEALTHCARE OF ONTARIO PENSION PLAN

The Healthcare of Ontario Pension Plan (“HOOPP”) is a multi-employer contributory defined benefit plan serving more than 295,000 working and retired healthcare workers. HOOPP was originally established by the Ontario Hospital Association (the OHA) in 1960. The Plan is registered under, and regulated by, the Pension Benefits Act (Ontario) and the Income Tax Act (Canada). As at December 31, 2014, it had \$60.8 billion in net assets.



OMERS ADMINISTRATION CORPORATION

Under the *Ontario Municipal Employees Retirement System* (“OMERS”) Act (Ontario), OMERS Administration Corporation (“OAC”) is the administrator of the OMERS pension plan, one of Canada’s largest multi-employer defined benefit pension plans, and trustee of the OMERS pension fund. As of December 31, 2014, OMERS has approximately \$72 billion in net assets and serves approximately 1,000 participating employers and approximately 450,000 employees and former employees of municipalities, school boards, libraries, police, and fire departments, children’s aid societies, and other local agencies across Ontario.

ONTARIO TEACHERS’ PENSION PLAN

Ontario Teachers' Pension Plan (“OTPP”) is Canada’s largest single-profession pension with \$154.5 billion in net assets as at December 31, 2014. It was created by its two sponsors, the Ontario government and the Ontario Teachers' Federation, and is an independent organization. In carrying out its mandate, OTPP administers the pension benefits of 311,000 working and retired teachers. OTPP operates in a highly regulated environment and is governed by the *Teachers' Pension Act* (Ontario) and complies with the *Pension Benefits Act* (Ontario) and the *Income Tax Act* (Canada).

PUBLIC SECTOR PENSION INVESTMENT BOARD

The Public Sector Pension Investment Board (“PSP Investments”) is one of Canada’s largest pension investment managers, with \$93.7 billion of net assets under management as at March 31, 2014. Its highly-skilled and dedicated team of professionals manages a diversified global portfolio including stocks, bonds and other fixed-income securities, and investments in private equity, real estate, infrastructure and renewable resources. PSP Investments is a Crown corporation established to manage employer and employee net contributions since April 1, 2000, to the pension funds of the Public Service of Canada, the Canadian Forces and the Royal Canadian Mounted Police, and since March 1, 2007, of the Reserve Force. PSP Investments’ head office is located in Ottawa, Ontario, and its principal business office is in Montréal, Québec.