

BY EMAIL

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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Re: Canadian Securities Administrators
Notice and Request for Comment on Proposed National Instrument 94-101 and
Proposed Companion Policy 94-101CP (*Mandatory Central Counterparty Clearing of*
***Derivatives*)**

On behalf of its members, the International Swaps and Derivatives Association, Inc.
(ISDA)¹ appreciates the opportunity to comment on (i) Proposed National Instrument 94-101 (the

¹ Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 64 countries. These members include a broad range of OTC derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including

Clearing Rule) and (ii) Proposed Companion Policy 94-101CP (the **Clearing CP**), which together address *Mandatory Central Counterparty Clearing of Derivatives* (together, the **Clearing Rule** and the **Clearing CP**, the **Proposed National Instrument**).

ISDA has long been a proponent of safe and efficient markets. As such, ISDA has been deeply engaged in the implementation of the G-20 commitments, both across G-20 jurisdictions and within each jurisdiction where ISDA members are located. ISDA comments, on mandatory clearing and other G-20 commitments, strive to reflect both (i) the breadth of ISDA experience and (ii) the depth of ISDA membership. On mandatory clearing in particular, ISDA is grateful to the Canadian Securities Administrators (**CSA**) for considering its input since 2012.² ISDA welcomes the prospect of continued dialogue as CSA moves towards finalizing the Proposed National Instrument.

1. *Product Determinations: General Thoughts*

Parts 4 and 6 of the Clearing CP set forth a non-exhaustive list of criteria that CSA members will consider in determining whether mandatory clearing shall apply to a particular derivative product or class of product (such determinations, the **Product Determinations**). ISDA notes that Parts 4 and 6 of the Clearing CP appear to broadly accord with the criteria employed by the United States³ and the European Union to make Product Determinations. The derivatives markets are global in nature, and ISDA generally supports harmonization across the G-20 jurisdictions.

Harmonization, however, is not an end in itself. It is meant to ensure that the G-20 jurisdictions achieve the systemic risk reduction that lies at the heart of the Pittsburgh and Cannes Commitments (the **Commitments**),⁴ while minimizing costs and maximizing operational feasibility for all market participants. In other words, the purpose of harmonization is to make sure that, within the supervisory and regulatory frameworks anticipated by the Commitments, the maximum number of market participants (including, *e.g.*, Canadian pension plans and insurance

exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

² See, *e.g.*, the Letter from ISDA to the CSA, dated September 21, 2012, on Consultation Paper 91-406 (Derivatives: OTC Central Counterparty Clearing), the Letter from ISDA to the CSA, dated March 26, 2014, on CSA Staff Notice 91-303 (the Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives), and the Letter from ISDA to the CSA, dated March 26, 2014, on CSA Staff Notice 91-304 (the Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral Positions). All such Letters may be found at: <http://www2.isda.org/regions/canada/>.

³ For purposes of this comment letter, the "United States" mainly refers to the Commodity Futures Trading Commission (**CFTC**).

⁴ See Leaders' Statement, Pittsburgh Summit, September 24-25, 2009 (stating that: "All standardized OTC derivative contracts should be...cleared through central counterparties...We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse") and Cannes Summit Final Declaration, November 4, 2011 (stating that: "We call on the Basel Committee on Banking Supervision (BCBS), the International Organization for Securities Commission (IOSCO) together with other relevant organizations to develop for consultation standards on margining for non-centrally cleared OTC derivatives by June 2012..."). Both the Statement and the Final Declaration are available on: <http://www.treasury.gov/resource-center/international/g7-g20/Pages/g20.aspx>.

companies) can continue to satisfy their risk management imperatives by accessing deep and liquid derivatives markets.

Therefore, while ISDA encourages harmonization, ISDA also recognizes that the G-20 jurisdictions may legitimately differ in implementation. In some cases, disparate legal frameworks may drive such differences. In other cases, local market conditions may result in such differences. ISDA believes in evidence-based regulation. Supervisors and regulators should examine all applicable facts, including costs and benefits, before making decisions. Consequently, ISDA supports the CSA statement that the “goal is to harmonize, *to the greatest extent appropriate*, the determination of mandatory clearable derivatives or classes of derivatives across Canada and with international standards” (emphasis added).

ISDA supports the two preliminary steps that the CSA has taken to decide what is appropriate. First, as noted above, Parts 4 and 6 of the Clearing CP set forth criteria for Product Determinations that appear to broadly accord with those in the United States and the European Union. However, ISDA also recognizes that Parts 4 and 6 of the Clearing CP contain more granularity than similar criteria in the United States and the European Union.⁵ Second, ISDA understands that CSA members expressly intend to look to “derivatives transaction data reported pursuant to local derivatives data reporting rules” for “key information in the determination process.” ISDA has worked extensively with the CSA on derivatives data reporting.⁶ ISDA believes that the CSA, in taking these two preliminary steps (*i.e.*, espousing more granular criteria and analyzing trade data), has positioned itself well to make Product Determinations that would best balance (i) the reduction of systemic risk at the center of the Commitments and (ii) the legitimate risk management needs of market participants.

2. *Product Determinations: Comments on Specific Provisions*

a. *Approach*

In both the United States and the European Union, relevant authorities have two methods of making mandatory clearing determinations.⁷ First, the relevant authorities can employ a “bottom-up” approach. In this approach, CCPs provide information to the relevant authorities on the derivatives products that they already clear (or that they contemplate clearing in the future). Through this information, CCPs substantiate why certain products are suitable for mandatory clearing. The relevant authorities then make a determination based on CCP information. Second, the relevant authorities can employ a “top-down” approach. In this approach, relevant authorities may decide that certain derivatives products or classes of products are suitable for mandatory clearing, even when no CCP is clearing (or contemplating clearing) those products or classes.

⁵ For example, Parts 4 and 6 specifically mention “the existence of third-party vendors providing pricing services.” Neither Section 2(h)(2)(B) of the United States Commodity Exchange Act (the **CEA**) nor Chapter IV of the European Market Infrastructure Regulation (**EMIR**) specifically mentions “third-party.” Section 2(h)(2)(B) of the CEA simply references “adequate pricing data,” whereas Chapter IV of EMIR references “fair, reliable and generally accepted pricing information.”

⁶ See, e.g., the Letter from ISDA to CSA members, dated March 24, 2015, on Proposed Multilateral Instrument 91-101 (Derivatives Product Determination) and Proposed Multilateral Instrument 96-101 (Trade Repositories and Derivatives Data Reporting), available at: <http://www2.isda.org/regions/canada/>.

⁷ For the United States, see 17 CFR Parts 39.5(b) (“bottom up”) and 39.5(c) (“top down”). For the European Union, see EMIR 5(1-2) (“bottom up”) and EMIR 5(3) (“top down”).

ISDA seeks clarification on the process by which CSA members may make mandatory clearing determinations. Parts 4 and 6 of the Clearing CP state: “NI 94-101 *includes* a bottom-up approach for determining whether a derivative or classes of derivatives will be subject to the mandatory clearing obligation.” The Proposed National Instrument remains silent on whether it *includes* or *excludes* a “top-down” approach. To avoid confusion, ISDA requests that the CSA explicitly state whether its members intend to only follow a “bottom-up” approach, or may additionally follow a “top-down” approach. If the latter, then ISDA requests that the CSA provide more detail on the manner in which the “top-down” approach would operate, including the circumstances under which CSA members would consider utilizing a “top-down” determination.

b. *Public Consultation*

ISDA welcomes the CSA statement that: “As part of the determination process, we will publish for comment the derivatives we propose to be mandatory clearable derivatives and invite interested persons to make representations in writing.” As mentioned above, ISDA believes in evidence-based regulation, and a combination of trade repository data, CCP submissions (assuming a “bottom-up” approach), and public comment would provide CSA members with the most holistic view of whether any particular derivatives product (or class thereof) is suitable for mandatory clearing, given the criteria articulated in Parts 4 and 6 of the Clearing CP.

ISDA does seek clarification on the amount of time afforded to the public for comment. The CSA states: “Except in Québec, the determination process is expected to follow our typical rule-making or regulation making process...In Québec, the determination process will be made by decision...”. For a “bottom-up” Product Determination, ISDA requests that the CSA confirm that the public will have a minimum of 90 days to comment, consistent with normal-course rulemaking, regulation making, or decision making processes. For a “top-down” determination, ISDA requests that CSA members afford the public more than 90 days to comment. Any lesser amount of time would compromise comment quality.

c. *Public Register*

ISDA is in favour of minimizing operational burdens on members. As noted above, the CSA states: “Except in Québec, the determination process is expected to follow our typical rule-making or regulation making process. The list of mandatory clearable derivatives will be included in the Clearing Rule as Appendix A, as amended from time to time. In Québec, the determination process will be made by decision and the list of mandatory clearable derivatives will appear on a public register kept by the Autorité des marchés financiers.” ISDA respectfully requests that CSA members coordinate to enable market participants to quickly access a list of all Product Determinations on one webpage. ISDA notes that this result could be achieved through hyperlinks between different websites.

3. *Mandatory Clearing Obligation: Scope.*

a. *Non-Systemic Entities.*

Subsection 5(1) of the Proposed National Instrument states: “A local counterparty to a transaction in a mandatory clearable derivative must submit, or cause to be submitted, that transaction for clearing to a regulated clearing agency that provides clearing services for that mandatory clearable derivative” (the **Mandatory Clearing Obligation**).

Part 3 of the Proposed National Instrument then sets forth two exemptions to the Mandatory Clearing Obligation. The first is the end-user exemption. The second is the intra-group exemption. Pursuant to Part 5 of the Proposed National Instrument, provincial regulators retain the authority to grant further exemptions. Indeed, the CSA contemplates that provincial regulators would “use trade repository data to investigate whether thresholds or carve-outs are appropriate for certain types of entities,” and that phasing in the Mandatory Clearing Obligation would provide provincial regulators enough time for such investigation.

As described in greater detail below, ISDA supports the phasing in of any Mandatory Clearing Obligation. However, ISDA notes that a phasing-in regime, coupled with the potential for *ad hoc* or categorical exemptions before Mandatory Clearing Obligations become effective still creates regulatory uncertainty. That uncertainty may have the greatest impact on those market participants whose derivatives activities are not systemic to either (i) the global derivatives markets or (ii) the markets within CSA jurisdiction (the **Non-Systemic Entities**). Under the phasing in contemplated in the Proposed National Instrument, the Non-Systemic Entities will assume that the Mandatory Clearing Obligation applies until a CSA member states otherwise. That assumption can easily result in unanticipated consequences, including for the real Canadian economy, as market participants decide whether and how to spend their capital.

ISDA respectfully suggests that there are benefits to the CSA explicitly exempting the Non-Systemic Entities from the Mandatory Clearing Obligation concurrently with finalizing the Proposed National Instrument or, in any case, well before proposing any Product Determination for public comment. ISDA observes that the United States and the European Union both contain broader exemptions for Non-Systemic Entities than those in the Proposed National Instrument. Of course, supervisors and regulators may legitimately differ in their implementation of the Commitments. Nevertheless, the United States and the European Union each have a larger presence in the global derivatives markets than all Canadian provinces combined. Hence, ISDA finds it surprising that the Canadian provinces would apply the Mandatory Clearing Obligation to more types of Non-Systemic Entities than the United States and the European Union.

ISDA notes that there is more than one way for the CSA to exempt the Non-Systemic Entities from the Mandatory Clearing Obligation. For example, in both the United States and under the Proposed National Instrument, if one party to a derivatives transaction is a “financial entity,” then any existing Mandatory Clearing Obligation would apply to that transaction. However, as compared to the Proposed National Instrument, the United States has a more restrictive “financial entity” definition. Specifically, the definition excludes certain “small financial institutions.” Therefore, those institutions may rely on the end-user exemption, as long as they meet certain other requirements (*i.e.*, hedging or mitigating commercial risk).⁸

The European Union takes a slightly different approach than the United States and the Proposed National Instrument. First, with respect to financial entities, the European Union exempts certain pension schemes from the Mandatory Clearing Obligation (i) for a defined period of time (*i.e.*, three years after the effective date of EMIR) and (ii) for derivatives transactions that reduce investment risk. Second, the European Union exempts non-financial entities from the

⁸ See 17 CFR 39.6(d).

Mandatory Clearing Obligation that fall below the “clearing threshold,” which is calibrated by asset class.⁹

ISDA acknowledges that the CSA may wish to take a different approach than the United States or the European Union in defining Non-Systemic Entity. ISDA believes that the CSA would be well positioned to develop such an approach after CSA members complete analyzing trade repository data.

ISDA understands the CSA position that “...the G20 has also committed to impose capital and collateral requirements on OTC derivative transactions that are not centrally cleared; the related costs *may well exceed* the costs associated with clearing OTC derivatives” (emphasis added). ISDA notes that the G-20 meant for increased capital and collateral requirements to incentivize clearing. Analysis of trade repository data may provide the CSA with a reasonable basis for concluding that Non-Systemic Entities should be incented to clear rather than being subject to a Mandatory Clearing Obligation.

b. *Governmental Entities, Central Banks, and Supra-National Agencies.*

ISDA supports Section 6 of the Proposed National Instrument, which exempts from the Mandatory Clearing Requirement derivatives transactions with (i) the Bank of Canada or a central bank of a foreign jurisdiction and (ii) the Bank for International Settlements. Nevertheless, ISDA would like to re-emphasize the importance of expanding Section 6 of the Proposed National Instrument to cover derivatives transactions with:

- Crown corporations that may be agents of the Crown. As agents, any liabilities of Crown corporations may in fact be those of the Crown in law, but the CSA jurisdictions in which Crown corporations were constituted do not necessarily guarantee such liabilities.
- Entities wholly-owned by the government of Canada, the government of a jurisdiction of Canada, or the government of a foreign jurisdiction, but which may not benefit from a guarantee from the relevant government.
- Recognized supra-national agencies, such as the International Monetary Fund.

Although not dispositive, both the United States and the European Union have advanced similar exemptions, based in part on considerations of comity and the traditions of the international financial system.

c. *Intra-Group Entities.*

ISDA supports Section 10 of the Proposed National Instrument, which exempts from the Mandatory Clearing Requirement certain transactions between “affiliated entities.” First, ISDA notes that the “affiliate entity” definition is not the same in the Proposed National Instrument as compared to the recent proposed multilateral instrument on trade reporting. ISDA understands that the CSA may be seeking to effectuate policy objectives by defining the same term differently in two separate proposals. However, ISDA respectfully submits that the CSA should weigh (i) the benefits of such objectives against (ii) the detriments that inhere to defining the same term differently (*e.g.*, increased confusion and operational difficulties).

⁹ See EMIR 11.

Second, ISDA would encourage the CSA to consider permitting two “affiliated entities” that are neither required to consolidate nor are supervised on a prudential basis to rely on the intra-group exemption, so long as such entities can demonstrate, through the Form 94-101F1 filing, that they satisfy the conditions set forth in Subsection 10(2) of the Proposed National Instrument. ISDA notes that this approach appears consistent with CSA intent in promulgating the intra-group exemption. For example, in Section 10 of the Clearing CP, the CSA states: “The exemption for intragroup transactions is based on the premise that the risk created by these transactions is expected to be managed in a centralized manner to allow for the risk to be identified and managed appropriately. Entities using this exemption should have appropriate legal documentation between the affiliated entities and detailed operational material outlining the robust risk management techniques used by the overall parent entity and its affiliated entities when entering into the intragroup transactions.” The CSA further states that: “We are of the view that a group of affiliated entities may structure its centralized risk management according to its unique needs, provided that the program reasonably monitors and manages risks associated with non-centrally cleared derivatives.”

Finally, pursuant to Section 3 of the Proposed National Instrument, one “affiliated entity” in each pairing must file a Form 94-101F1 to relevant provincial regulators. It is highly likely that Section 3 of the Proposed National Instrument would result in the “affiliated entity” making submissions to multiple provincial regulators. ISDA is in favor of the CSA exploring a more efficient procedure for “affiliated entities” to make Form 94-101F1 filings. For example, the CSA could allow “affiliated entities” to make one submission to an approved trade repository. Alternatively, “affiliated entities” could file one Form 94-101F1 with the CSA, which would then be shared with all applicable provincial regulators.

4. *Phase-In.*

a. *Evidence-Based Regulation.*

ISDA supports the phasing-in of the Mandatory Clearing Obligation. As mentioned above, ISDA believes that the CSA may maximize the benefits of phasing-in by taking a number of preparatory actions. In taking these actions, ISDA urges CSA members to coordinate to the maximum extent possible. ISDA suggests the following sequence:

- CSA members start collecting trade repository data.
- After a certain period of time, CSA members deem that trade repository data is sufficient, at a minimum, to support (i) categorization of entities that participate in the derivatives markets within CSA jurisdiction (*e.g.*, (i) market makers, (ii) non-market makers (financial and non-financial), and (iii) participants hedging and/or mitigating commercial risk), (ii) analysis of the patterns of participation, including the volume of derivatives transactions (both cleared and uncleared), and (iii) assessment of the risks posed by such patterns, including whether those risks are likely to be systemic.
- Based on its exploration of trade repository data, CSA members identify the universe of Non-Systemic Entities. CSA members then consider whether it would be appropriate to exempt Non-Systemic Entities from the Mandatory Clearing Obligation.
- Ideally, the CSA would wait to finalize the Proposed National Instrument until after it reaches a uniform decision on whether an exemption should be afforded to Non-Systemic Entities.

However, if that does not occur, CSA members should still wait to propose Product Determinations until after they have made decisions on such exemption(s).

- The public has at least 90 days (more for a “top-down” determination) to comment on any Product Determination proposal.
- CSA members digest public comments and finalize a Product Determination.
- Using trade repository data, CSA members decide which entities should fall within which phase-in categories (e.g., Category One – Clearing members).
- CSA members then set the phase-in time periods for each category.

ISDA recognizes that CSA members may need to adjust the above sequence to reflect certain legal and practical obstacles to phasing in the Mandatory Clearing Obligation. Such obstacles are described in greater detail below.

b. *Interconnection with Amendments to Personal Property Security Law*

In considering whether and how the Mandatory Clearing Obligation should apply to entities outside of Category One, the CSA should consider the obstacles that such entities face in accessing client clearing services. As ISDA has noted previously, one such obstacle is the current state of provincial law governing security interests in personal property (the **Provincial Laws**). With the exception of Québec, the Provincial Laws do not permit security interests in cash collateral to be perfected through control. For uncleared derivatives, the Provincial Laws have negatively impacted the willingness of a counterparty to deal with, e.g., a Non-Systemic Entity. Similarly, the Provincial Laws may negatively impact the willingness of clearing members to provide services to, e.g., a Non-Systemic Entity. ISDA reiterates the importance of amending all Provincial Laws to permit perfection through control for cash collateral, before the Mandatory Clearing Obligations become effective for entities outside of Category One. In general, ISDA respectfully requests that the CSA consider the manner in which CSA Staff Notice 91-304 and the Proposed Model Provincial Rule on *Derivatives: Customer Clearing and Protection of Customer Collateral Positions* interact with Mandatory Clearing Obligations for entities outside of Category One.¹⁰

c. *Interconnection with Mutual Recognition and Substituted Compliance*

i. *Within Canada*

Within Canada, the derivatives markets cross CSA jurisdictions. Therefore, ISDA supports the CSA intent behind the following statement: “The Clearing Rule provides substituted compliance for transactions involving a local counterparty where the transaction is submitted for clearing pursuant to the laws of a jurisdiction of Canada other than the jurisdiction of the local

¹⁰ See Letter from ISDA to the CSA, dated March 26, 2014, on CSA Staff Notice 91-304 (the Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral Positions), available at: <http://www2.isda.org/regions/canada/>.

counterparty...”. Nevertheless, ISDA requests clarification on how the CSA has expressed this intent in the actual text of the Clearing Rule.

- First, Subsection 5(4) of the Clearing Rule references only (i) Newfoundland and Labrador, (ii) the Northwest Territories, (iii) Nunavut, (iv) Prince Edward Island, and (v) Yukon.
- Second, Section 1 of the Clearing Rule defines “regulated clearing agency” as (i) “a person or company recognized or exempted from recognition as a clearing agency in the local jurisdiction,” in all jurisdictions other than Québec and (ii) “a person recognized or exempted from recognition as a clearing house” in Québec.
- Together, Section 1 and Subsection 5(4) of the Clearing Rule should let a “local counterparty” in one CSA jurisdiction satisfy its Mandatory Clearing Obligation by clearing with a “regulated clearing agency” in any other CSA jurisdiction.
- ISDA respectfully suggests that the CSA ensure substituted compliance within Canada before finalizing any Product Determination.

ii. *Between Canada and Other G-20 Jurisdictions.*

As referenced above, the derivatives markets are global in nature. Often times, two counterparties to one derivatives transaction are located in separate G-20 jurisdictions. As more G-20 jurisdictions implement mandatory clearing, there must be a working framework between such jurisdictions for mutual recognition and substituted compliance. ISDA believes that such a framework should focus on regulatory outcomes, rather than a *pro forma*, granular comparison of regulatory language. ISDA submits that such a framework is evolving between, *e.g.*, the United States and the European Union. In the same vein, the Proposed National Instrument states: “...the Committee continues to monitor the development of cross-border guidance with respect to substituted compliance on clearing requirements.” The CSA may reasonably wait to articulate its stance on mutual recognition and substituted compliance after the dialogue between, *e.g.*, the United States and the European Union, has completed. However, ISDA believes that no Product Determination should become effective, regardless of Category, until the CSA details its stance on mutual recognition and substituted compliance.

ISDA appreciates the opportunity to provide input on the Proposed National Instrument. ISDA would be pleased to work with CSA further it moves towards finalizing the Proposed National Instrument. Please feel free to contact me or ISDA staff at your convenience.

Yours truly,

A handwritten signature in black ink, appearing to read 'Katherine Darras', with a large, stylized initial 'K'.

Katherine Darras
General Counsel, Americas