

February 2, 2016

The Secretary
Ontario Securities Commission
20 Queen Street West
Toronto, Ontario
M5H 3S8
comments@osc.gov.on.ca



Dear Sirs/Mesdames:

Re: Request for Comments on Amendments (the “Amendments”) to Regulation/Rule 91-507 *Trade Repositories and Derivatives Data Reporting* (the “TR Rule”) and the related Companion Policy

INTRODUCTION

The Canadian Market Infrastructure Committee (“**CMIC**”)¹ welcomes the opportunity to comment on the Amendments.²

General Comments

CMIC has consistently supported derivative reform that is harmonized, both globally (wherever it makes sense from a Canadian market perspective), as well as within Canada. From a Canadian perspective, we note that there are still differences between the Ontario, Quebec and Manitoba rules. One example of such a difference relates to the determination of reporting party. In Ontario, if two dealers have not entered into the ISDA multilateral agreement, both dealers are the reporting parties but in Quebec, only the local counterparty will be the reporting party. Another example relates to the difference between the definition of “affiliate”. In Ontario, the definition of “affiliate” in section 1(2) of the Securities Act, along with the related definitions of “controlled companies” and “subsidiary companies” in sections 1(3) and 1(4) respectively, do not clarify how affiliates of partnerships or trusts can be determined. However, the proposed amendments to Quebec’s Regulation 91-507³, clarifies

¹ CMIC was established in 2010, in response to a request from Canadian public authorities, to represent the consolidated views of certain Canadian market participants on proposed regulatory changes in relation to over-the-counter (“**OTC**”) derivatives. The members of CMIC who are responsible for this letter are: Alberta Investment Management Corporation, Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ (Canada), Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Citigroup Global Markets Inc., Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan, HSBC Bank Canada, JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers’ Pension Plan Board, Royal Bank of Canada, Sun Life Financial, The Bank of Nova Scotia, and The Toronto-Dominion Bank. CMIC brings a unique voice to the dialogue regarding the appropriate framework for regulating the Canadian over-the-counter (“**OTC**”) derivatives market. The membership of CMIC has been intentionally designed to present the views of both the ‘buy’ side and the ‘sell’ side of the Canadian OTC derivatives market, including both domestic and foreign owned banks operating in Canada. As it has in all of its submissions, this letter reflects the consensus of views within CMIC’s membership about the proper Canadian regulatory regime for the OTC derivatives market.

² See http://www.osc.gov.on.ca/documents/en/Securities-Category9/rule_20151105_91-507_derivatives-data-reporting.pdf.

³ See <https://www.lautorite.qc.ca/files/pdf/bulletin/2015/vol12no44/vol12no44.pdf> at pg. 286.

how affiliates of partnerships can be determined, but is silent with respect to trusts, and in Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting*,⁴ there is yet another proposed difference relating to how affiliates of both partnerships and trusts are determined. This last point is particularly important as the result could be that the inter-affiliate exemption from reporting trades may be available in one Canadian province but may not be available in another simply due to the differences in the definition of “affiliate”. In CMIC’s view, all trade reporting rules within Canada should be harmonized and regulatory authorities should include amendments to harmonize the trade reporting rules for these three Provinces in the Amendments.

With regard to the proposed July 29, 2016 effective date for public dissemination of transaction data, a market participant’s ability to meet this deadline is dependent upon the trade repository’s own ability to build and test the necessary infrastructure by that date. In addition, market participants will also need several months from the availability of final specifications from their trade repository in order to develop and test the new functionality internally. Therefore, before finalizing the July 29, 2016 effective date in the Amendments, CMIC encourages the OSC to engage in a detailed and frank discussion with the trade repositories in order to determine a realistic effective date for public dissemination of transaction data.

(a) Subsection 26(5): duty to report; exemption for reporting derivatives data for transactions with foreign affiliates

CMIC supports the expansion of substitute compliance to non-derivatives dealers and non-clearing agencies, provided that the conditions (the “Conditions”) under paragraphs 26(5)(a) through (c) of the TR Rule are satisfied. This proposed amendment to subsection 26(5) of the TR Rule alleviates the burden of double reporting for counterparties who are already required to report their derivatives transactions under established and reliable reporting legislation elsewhere in the world. However, the substitute compliance under the proposed TR Rule has limited benefit for two main reasons. First, the Condition that requires trades to be reported to a recognized trade repository does not take into account the fact that trade repositories have set up different legal entities for doing business in different jurisdictions. Therefore, a trade reported, for example, under EMIR to DTCC is to the European subsidiary of DTCC and not to the trade repository recognized under the TR Rule. Second, the Condition that requires the reporting counterparty to instruct a recognized trade repository to provide the transactional data to the regulatory authority still requires the reporting party to report the relevant provincial information to the recognized trade repository, thus negating the benefit of substitute compliance.

With respect to the first limitation identified above, CMIC recommends that the substitute compliance provisions under the TR Rule (in respect of all circumstances and not only in respect of inter-affiliate trades) should allow for trades to be reported not only to a recognized trade repository but also to majority-owned subsidiaries of recognized trade repositories. With respect to the second limitation identified above, CMIC encourages all Canadian regulators of OTC derivatives to enter into memoranda of understanding with regulators in other jurisdictions to obtain direct access to relevant derivatives data that has been reported subject to another recognized jurisdiction’s requirements. This would eliminate the need for the reporting party to specifically authorize access on a trade-by-trade basis.

(b) *Section 28: Legal entity identifiers; entity ineligible to receive a legal entity identifier*

⁴ See http://www.albertasecurities.com/Regulatory%20Instruments/5218949-v1-CSA_Notice_re_MIs_96-101_and_Annexes.pdf at pg. 3 of Annex D.

CMIC is supportive of the proposed amendment to section 28 of the TR Rule to provide for situations where a counterparty to a transaction is not eligible to receive a legal entity identifier (LEI) as determined by the Global Legal Entity Identifier System (the “GLEI System”). However, CMIC is concerned that in the future, the GLEI System may allow LEI’s to be issued for individuals and sole proprietorships. If that happens, reporting parties would be required to report the LEI for individuals and sole proprietorships under proposed Section 28(4) which could result in a breach of privacy laws in certain jurisdictions. Nevertheless, CMIC recommends a slight change in the wording of proposed section 28(4) and in Appendix A to address this issue, as follows:

28...(4) If a counterparty to a transaction is not eligible to receive a legal entity identifier as determined by the Global Legal Entity Identifier System or is an individual, the reporting counterparty must identify such a counterparty with an alternate identifier.

Appendix A “Identifier of reporting counterparty:” LEI of the reporting counterparty or, in the case of a counterparty that is not eligible to receive an LEI or an individual, its alternate identifier

(c) *Section 28.1: Requirement to obtain a legal entity identifier*

CMIC supports the proposed amendment under section 28.1 of the TR Rule to obligate each eligible local counterparty to a transaction that is required to be reported under the TR Rule to obtain an LEI in accordance with the standards set by the GLEI System.

(d) *Subsection 39(3) & Appendix C: Data available to public; public dissemination of transaction-level data*

CMIC is supportive of the OSC’s thoughtful approach to the scope of public dissemination of transaction level data, and in general, is supportive of the approach proposed with respect to asset classes and caps. In particular, we confirm that CMIC fully supports the proposal to exclude cross-currency swaps from public dissemination. However, CMIC believes there are still circumstances where the proposed public dissemination rules will not protect the anonymity of the parties, which could make hedging the risks of a transaction more difficult and expensive as market participants may adjust the pricing in anticipation of the hedging needs of such parties. Accordingly, the recommendations under the following paragraphs (i)-(vi) are made in order to fully protect the anonymity of the parties in the much smaller Canadian OTC derivatives market.

We note that even if our recommendations below are adopted, because the Canadian market is so small, when very large notional interest rate transactions are being entered into, it is easy to reverse-engineer such transactions and be able to identify the likely specific party to those transactions, particularly where the counterparty is a provincial government seeking to hedge a particular long term risk in connection with its treasury operations. The market knows that provincial governments issuing long term bonds will often enter into derivatives transactions at the same time the bonds are issued in order to hedge interest rate risks in connection with those bonds. Therefore, the identity of the provincial government could easily be determined by matching the maturity date of the interest rate transaction with the maturity date of the bond issuance. CMIC recommends that the OSC consult with the treasury units of each provincial government to ensure that they are aware that the public dissemination requirements may not provide them with anonymity. If anonymity is desired, CMIC recommends that the specific maturity date of the transaction not be publicly disclosed and instead, the term of the transaction could be disclosed in general terms, for example, “greater than 10 years”.

(i) Rates

The liquidity in interest rate OTC derivatives drops—off rapidly as you move out the curve. The current proposal in Appendix C applies a \$50 million cap to any trade with maturity greater than 10 years. In CMIC's view, this is insufficient for longer-dated transactions. We therefore suggest a \$20 million cap for trades with a maturity greater than 20 years. If this suggestion is not adopted, in our view, a market participant's ability to hedge their transactions could be negatively impacted. For example, it would not be uncommon for a dealer to run open risk on a 30 year swap for one week. T+1 disclosure could harm that dealer as it would still be in the market hedging that transaction when the public report is released.

(ii) Credit & Equity

CMIC notes that the size of the OTC derivatives market in Canada and the limited number of market makers for specific products on indices, whether a major index or a sub-index, results in certain transactions being vulnerable to reverse engineering. Based on the information proposed to be disseminated in Appendix C, we are particularly concerned about public dissemination of information relating to the strike price and option type. Accordingly, CMIC urges the OSC to recognize that transactions on sub-indices are quite illiquid in Canada and, therefore, CMIC recommends excluding these sub-index transactions from public dissemination. If these transactions on sub-indices were to be publicly disseminated, the underlying asset and option type would be disclosed, which would easily impact a market participant's ability to hedge risk and potentially actually shift the market for the underlying sub-index itself. Alternatively, in order to protect the market, CMIC supports a rule that masks the name of the index and strike price from public dissemination.

In addition, it is CMIC's strong view that Appendix C should expressly provide that option transactions on bespoke baskets should not be publicly disseminated.

With respect to the proposed capped rounded notional amounts set out in Table 4 to Appendix C, in order to further protect the anonymity of the parties in this illiquid credit and equity derivatives market, CMIC recommends changing the capped rounded notional amount for credit and equity from CAD 50 million to CAD 20 million. We note that this point is not an alternative to the recommendations set out in the first paragraph of this section. Even if the capped amount were to change to CAD 20 million, in CMIC's view, for the reasons stated above, sub-index transactions should not be publicly disseminated or, in the alternative, the index name and strike price should be masked from public dissemination.

We note for future consideration that the single name OTC option market in Canada is relatively illiquid and should not be considered for public reporting in the future. Public dissemination of transactions in illiquid products will create unhelpful arbitrage opportunities. One of the reasons market participants trade OTC options is to preserve anonymity and to avoid trading on an exchange where the size of their transactions could move markets and adversely impact pricing and their ability to hedge.

(iii) Foreign Exchange Transactions

CMIC strongly agrees with the decision to expressly exclude foreign exchange transactions (including cross-currency transactions) from public dissemination. This is particularly important given that foreign exchange swaps and forwards are out of scope for public reporting requirements under CFTC

rules. In CMIC's view, there would be a significant deterrent for US market participants to trade with Canadian market participants if foreign exchange swaps and forwards were publicly disseminated in Canada but not in the US. In fact, it is CMIC's view that foreign exchange transactions should never be in scope for public dissemination in Canada given that foreign exchange swap markets in Canada are relatively small wholesale markets.

(iv) Commodities

In CMIC's view, it is appropriate to exclude Canadian OTC commodity markets from public dissemination of transaction data, both now and in the future. The Canadian market is much less mature than other OTC derivatives markets, with only one or two dealers making markets in certain products. Public dissemination of transaction level data could significantly impair a market intermediary's ability to hedge its risk. In addition, commodities as a category also represent a more diverse set of underlying products, which makes it exceptionally difficult to set appropriate notional caps.

(v) Timing of public dissemination

Paragraph 7 of Appendix C requires public dissemination of transaction level data "no later than" T+1. If information is publicly disseminated prior to T+1, any benefit of delayed reporting under Canadian TR Rules would be lost and the anonymity of Canadian market participants could well be lost in such circumstances. Therefore, CMIC submits that the rule should specifically require public dissemination on a T+1 basis (and not before), although we recognize that adopting such a rule may mean that the trade repository itself may not be able, logistically, to achieve public reporting dissemination on a T+1 basis where market participants themselves report transactions to the trade repository on T+1.

(vi) Rounded Notional Amounts

With respect to the proposed rounded notional amounts set out in Table 3 of Appendix C, it is CMIC's view that these should be further refined. Due to the small size of the Canadian OTC derivatives market, using the proposed rounding could render the transactions vulnerable to reverse engineering, which may harm a party's ability to hedge its risks and compromise the integrity of the market. We therefore propose the following changes to Table 3:

- if the Reported Notional Amount of Leg 1 or 2 is below \$1 million, the reported amount should simply state "under \$1 million";
- if the Reported Notional Amount of Leg 1 or 2 is equal to or greater than \$1 million but less than \$10 million, round to the nearest million (and not \$100,000 as currently proposed); and
- if the Reported Notional Amount of Leg 1 or 2 is equal to or greater than \$10 million but less than \$50 million, round to the nearest \$5 million (and not \$1 million as currently proposed).

(e) *Section 41.1: Exclusions; exclusion from requirement to report end-user inter affiliate transactions*

CMIC supports the proposed exclusion from reporting derivatives data to a trade repository under section 41.1 of the TR Rule for inter-affiliate transactions between end-user local counterparties. We note that notices by each of the three provincial securities commissions were published informing the

market that such commissions would not be enforcing the requirement to report inter-affiliate transactions. As the proposed provision does not exclude all inter-affiliate transactions, some end-users may have not reported an inter-affiliate transactions with a non-local counterparty in reliance on such notices. It is CMIC's view that the Amendments should clarify that the reporting date for inter-affiliate transactions between end-users is the effective date of the Amendments, as opposed to requiring parties to go back and report transactions as of the original dates of June 30, 2015 and December 31, 2015, as applicable.

CMIC welcomes the opportunity to discuss this response with you. The views expressed in this letter are the views of the following members of CMIC:

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

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