

May 24, 2016

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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Dear Sirs/Mesdames:

The Canadian Bankers Association (**CBA**)¹ appreciates the opportunity for market participants to comment on Proposed National Instrument 94-101 – *Mandatory Central Counterparty Clearing of*

¹ The CBA works on behalf of 59 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 280,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The CBA also promotes financial literacy

Derivatives (the **Proposed Rule**) published by the Canadian Securities Administrators (**CSA**) on February 24, 2016. This comment letter is submitted on behalf of Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce, Royal Bank of Canada and Toronto Dominion Bank (together, the **Canadian Banks**).

In the Proposed Rule, the CSA Derivatives Committee (the **Committee**) has requested the views of market participants on whether the scope of counterparties subject to the clearing requirement is appropriate considering the determination of certain derivatives as being mandatorily clearable. The CBA appreciates that the Committee has significantly scaled back the scope of counterparties subject to the clearing requirements relative to the previous version of the Proposed Rule. We note, however, that the reduction in scope means that the clearing requirements would – at this time – effectively only apply to the Canadian Banks. As federally regulated financial institutions, the Canadian Banks are already subject to the clearing requirements set out in Guideline B-7 *Derivatives Sound Practices*, issued by the Office of the Superintendent of Financial Institutions (**OSFI**).

Further, the Canadian Banks are already subject to OSFI's compliance oversight and enforcement authority in this area. Given the systemic risk implications of clearing requirements, and given that the Proposed Rule will have the greatest impact on the Canadian Banks, we believe that oversight and enforcement of clearing requirements applicable to the Canadian Banks properly rests within the prudential mandate and jurisdictional authority of OSFI. Therefore, we caution against the prescriptive rule-based approach of the Proposed Rule and the creation of provincial compliance oversight and enforcement mechanisms that duplicate, or could conflict with, OSFI's authority over the Canadian Banks with respect to clearing requirements. We are particularly concerned about prospective rules that could require lengthy consultations for revisions or amendments between multiple regulatory authorities (both provincial and federal) in response to market events that require swift regulatory actions. In the context of clearing, the principles-based approach to regulation permits prudential regulators to implement such regulatory actions in a timely manner. Having noted these concerns, we would like to highlight aspects of the Proposed Rule that pose particular challenges for the Canadian Banks.

Identification of Counterparties

We are supportive of the requirement in subsection 3(1)(a) of the Proposed Rule, which requires counterparties that are participants of a regulated clearing agency to clear mandatory clearable derivatives. We do, however, have concerns about the obligation to identify the category of counterparties under subsections 3(1)(b) and (c) of the Proposed Rule. As the Proposed Rule is currently drafted, the only way for a Canadian Bank to determine whether a counterparty satisfies the requirements of subsections 3(1)(b) or (c) is by conducting an outreach to each and every client in order to confirm their status. Guideline B-7 does not give rise to this requirement relating to identification of counterparties. The Canadian Banks' experience with similar outreach in the context of the trade reporting rules indicates that it is highly unlikely that the Canadian Banks will receive a 100% response rate to such outreach, notwithstanding the time, efforts and resources expended by the Canadian Banks in procuring responses from clients. Not receiving a client's response in the clearing context has more significant negative consequences than trade reporting context because, in the former case, the parties to the transaction need to know

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whether the transaction will be cleared because of the impact of clearing on pricing and settlement of the transaction.

Filing Requirement for Intragroup Exemption

Another aspect of the Proposed Rule that is of concern to us is that a local counterparty must file a Form F1 with the regulators before parties are able to transact in reliance on the intragroup exemption. Guideline B-7 does not give rise to a requirement relating to documentation necessary to rely on the intragroup exemption. In the current Canadian context, this would mean that the Canadian Banks would have to submit the form to multiple regulators. In contrast, the U.S. *Dodd-Frank Act* permits the form to be filed with a trade repository.

Non-systemically Important Counterparties

The Proposed Rule would capture bank affiliates that are largely end-users of derivatives where the notional trading activity is *de minimis* and not of systemic importance simply because they are affiliated with a clearing participant that is a Canadian Bank. The purpose of establishing clearing requirements is to reduce systemic risk in the derivatives market and increase financial stability. Mandatory clearable derivatives entered into by such small affiliates of clearing participants do not contribute to systemic risk or to financial instability.

Terminating or Suspending Clearing Obligations

The Proposed Rule may not be sufficiently responsive to market developments, as there is currently no mechanism in the Proposed Rule to terminate or suspend a mandatory clearing mandate. Under OSFI's prudential supervision, Canadian Banks are given clear incentives to centrally clear derivatives through reduced capital requirements. However, Canadian Banks have the operational and business flexibility under Guideline B-7 to suspend or terminate clearing in response to a crisis involving an important central clearing counterparty (CCP) that clears that product. For example, the clearing mandate for a class of contracts may need to be suspended if the liquidity of the class has deteriorated, making it difficult for the CCP to manage the risk of that class. Other circumstances where clearing may need to be suspended or terminated is when a CCP that clears a specific class of instruments is de-authorized or de-recognized or when a CCP is subject to recovery and resolution measures because of multiple member defaults. Market events such as default could take place very rapidly and may require a decision in a matter of days. If there was a need to suspend or withdraw the clearing obligation because of such a rapid market event, an agile, principles-based approach is needed to ensure that there are no adverse unintended market consequences. We are concerned that the CSA's approach to rule-making or amendments to the Proposed Rule would not be sufficiently agile to meet market needs, as consensus with multiple regulatory authorities (both provincial and federal) could be required to suspend or terminate a mandatory clearing mandate. In line with our comments, the European Securities and Markets Authority identified the lack of a mechanism to temporarily suspend the clearing obligation when the situation would require such suspension as the most problematic issue with regard to the European Market Infrastructure Regulation (EMIR). Similarly, the European Systemic Risk Board calls for swift processes for the removal or suspension of mandatory clearing obligations if the relevant market situation so requires. Finally, the International Swaps and Derivatives Association is also advocating for provisions permitting the temporary suspension of the clearing obligation under EMIR.

Proper Application of the Rule

We appreciate the opportunity to contribute to the process of developing a coherent regulatory framework for OTC derivatives in Canada. However, consistent with our practice in these

matters, our comments in this letter are meant to address the provisions of the Proposed Rule without regard to the manner or extent (if any) to which the Proposed Rule may properly apply to the Canadian Banks. In particular, there is a long-standing and unresolved tension in Canada between the positions of federal and provincial regulatory authorities as to whether Canadian chartered banks are properly subject to regulations promulgated under the legislative authority of the provinces in relation to the derivatives trading activities of the banks. In light of this uncertainty, our comments in this letter are made without prejudice to or limitation on any future assertions we or the Canadian Banks may make that the Proposed Rule, in whole or part, does not properly apply to the Canadian Banks or their business. Accordingly, this letter should not be taken to suggest that the Canadian Banks accept or accede to the jurisdiction or authority in this context of provincial securities laws, provincial derivatives laws or the rules promulgated by provincial securities or derivatives regulatory authorities.

We would appreciate the opportunity to discuss our concerns further with the Committee and believe it would be helpful to have such discussions jointly with OSFI and the other relevant federal regulators. Thank you for the opportunity to provide our views on this important issue. Please contact us with any questions or comments.

Yours truly,

A handwritten signature in black ink, consisting of stylized initials followed by a long horizontal line ending in a small circle.