September 6, 2016

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

Robert Blair, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
Fax: 416-593-2318
E-mail: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec
H4Z 1G3
Fax : 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

VIA EMAIL

RE : CSA Notice and Request for Comment ("CSA Notice") on CSA Consultation Paper 95-401 – *Margin and Collateral Requirements for Non-Centrally Cleared Derivatives* (the "Consultation Paper")

Custom House ULC doing business as Western Union Business Solutions ("WUBS," "we," or "us") appreciates the opportunity to comment on the Consultation Paper. Capitalized terms used in this letter and not defined herein have the meanings ascribed to them in the Consultation Paper or in Guideline E-22 (defined below), as applicable.

About Western Union

WUBS is a Money Service Business that is registered with the Financial Transactions and Reports Analysis Centre of Canada that operates a foreign exchange ("FX") and cross border payment service in Canada. As part of that business, WUBS currently offers FX forwards and FX options, both of which products would be subject to the rules contemplated by the Consultation Paper ("Proposed Regulations").

WUBS recognizes the global trend toward greater regulatory oversight of derivatives dealing and its affiliates in the United States and Europe have implemented or are currently implementing many of the changes brought about by, respectively, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank") and the *European Market Infrastructure Regulation*. As

noted by the Consultation Paper, the Proposed Regulations would align Canada with other major markets globally and will promote uniformity in regulatory oversight and market processes, and we view this alignment as a positive development.

Our comments are as follows.

1. *Variation margin should not be required for physically settled FX forwards and FX swaps, consistent with OSFI's Guideline E-22, the BCBS-IOSCO Standards and certain other major jurisdictions' rules*

Paragraph 2 of the Consultation Paper states that: "Variation margin requirements [will] … apply to all FX derivatives including all components of cross-currency swaps." Requiring variation margin for physically settled FX forwards and FX swaps is inconsistent with Guideline E-22 ("Guideline E-22") of the Office of the Superintendent of Financial Institutions Canada ("OSFI"), the standards developed jointly by the Basel Committee on Banking Supervision and the International Organization for Securities Commission (together, "BCBS-IOSCO") in its paper "Margin requirements for non-centrally cleared derivatives" (the "BCBS-IOSCO Standards") and, we understand, the rules promulgated under Dodd-Frank and in Japan.

Guideline E-22, for example, provides at paragraph 20 that "[t]he margin requirements outlined in this Guideline apply to all non-centrally cleared derivatives with the exception of physically settled foreign exchange (FX) forwards and FX swaps." Similarly, the BCBS-IOSCO Standards state, in paragraph 1.1, that "[e]xcept for physically settled FX forwards and swaps, the margin requirements apply to all non-centrally cleared derivatives. The margin requirements described in this paper do not apply to physically settled FX forwards and swaps."

Although we are aware of bank supervisory guidance that suggests that such transactions should be subject to variation margining, it is not clear the extent to which market participants are bound by such guidance and whether the standards under such guidance are the same as would apply under the Proposed Regulations. As such, subjecting such transactions to the Proposed Regulations could potentially put WUBS and similarly situated market participants at a competitive disadvantage relative to OSFI-regulated financial institutions and foreign market participants that are subject to regulations that adhere to the BCBS-IOSCO Standards and carve out physically settled FX transactions from regulation. Even if variation margining of physically settled FX forwards and FX swaps is market practice for certain segments of the market, the CSA should not impose a regulatory mandate on all participants.

Moreover, there are sound reasons why physically settled FX forwards and FX swaps should be excluded from variation margin rules, both under the Proposed Regulations and more generally. These products are functionally different from other OTC derivatives, because physically settled FX swaps and FX forwards involve an actual exchange of principal, are predominantly very short in duration and have high turnover rates. Counterparty credit risk is therefore less of a concern for physically settled FX swaps and FX forwards.

Scotia Plaza
100 Yonge Street
15th Floor
Toronto, ON M5C 2W1
Business.westernunion.ca

2. *Broad-based substituted compliance should be permitted; a "rule-by rule" approach to substituted compliance should be avoided.*

Paragraph 29 of the Proposed Regulations states that "Covered entities entering into a derivative with a foreign counterparty that is a covered entity but not a local counterparty and is subject to and complies with rules imposed by a regulatory authority in the foreign counterparty's home jurisdiction that are assessed to be equivalent to these margin requirements and meet the BCBS-IOSCO Standards would be relieved from these margin requirements. The counterparties would decide whether the derivative would be subject to these margin requirements or the rules of the foreign counterparty's home jurisdiction that are assessed to be equivalent to these margin requirements."

WUBS strongly supports the inclusion of a substituted compliance framework in the Proposed Regulations. In our view, in order for substituted compliance to function properly, in a way that avoids simultaneous application of overlapping rules under different regimes, the CSA should adopt a broad-based approach to substituted compliance and the related equivalence determinations, as opposed to a granular, "rule-by-rule" approach. Under a broad, outcomes-based approach to equivalence determinations, the CSA would consider a foreign regime in its entirety and either recognize the regime (or not) on an "all or nothing" basis for substituted compliance purposes. Such an approach would simplify considerably the implementation of the Proposed Regulations, particularly since most, if not all, of the jurisdictions that would be suitable candidates for substituted compliance have in place local rules that overlap significantly with the requirements contemplated by the Proposed Regulations.

As an example of the difficulties that could arise if the CSA adopts a "rule-by-rule" substituted compliance approach, please see paragraph 28 of the Proposed Regulations, which states that "***Covered entities that are not FRFIs, satisfy [the Proposed Regulations] if they enter into a derivative with a FRFI that is subject to the OSFI Guideline and they exchange margin for that derivative in accordance with [Guideline E-22].***" (Emphasis added). This language could be taken to mean that substituted compliance with Guideline E-22 by a CSA "covered entity" trading with a "Covered FRFI" would not exclude the application of the CSA's requirement to exchange variation margin in respect of physically settled FX forwards and FX swaps, because Guideline E-22 does not require variation margin to be exchanged for such trades. We assume that is not the intention given the statement in the Consultation Paper that "[i]n reviewing the OSFI Guideline using a flexible, outcomes-based, category-by-category approach, the Committee believes that the requirements in the OSFI Guideline are equivalent to the recommendations described in this consultation paper."

We respectfully submit that a better approach to substituted compliance would permit CSA "covered entities" to *entirely* rely on a Covered FRFI's compliance with Guideline E-22 when transacting with a Covered FRFI, including permitting the Covered FRFI not to be required to collect or post variation margin in respect of physically settled FX forwards and FX swaps. In the context of foreign regimes, there will be numerous instances where the equivalent foreign rules are incrementally more or less onerous than the Proposed Regulations. Requiring CSA "covered

entities" to perform a "strictest rule"-type analysis when transacting with foreign counterparties to determine how and when compliance with the foreign rule is required and how and when compliance with the Proposed Regulation is required would render the benefits of any substituted compliance regime largely illusory.

3. *For certain market participants, the requirement to calculate initial margin requirements using either a model or the "standardized initial margin schedule" could prove an unfair and unnecessary impediment to transacting.*

WUBS does not currently have access to or determine initial margin requirements for its FX trades using an enterprise wide initial margin model (the "model"), and we believe that the costs of independently developing and having such a model approved could prove prohibitive. Moreover, the requirement in the CSA's standardized initial margin schedule to exchange initial margin of 6% of an FX trade's notional exposure would similarly prove prohibitive and limit WUBS' ability to offer FX derivative products to its customers that are in scope for initial margin payments. We ask that the CSA take these circumstances into account when promulgating final rules regarding model development and approval and the standardized initial margin schedule. Entities such as WUBS that are not FRFIs and focus on serving smaller businesses and commercial hedgers may be unfairly disadvantaged in seeking to provide FX derivative products to local covered entities that do not have models in place (ie. a commodity broker which previously engaged with WUBS for FX derivatives). Customers without models may have no option but to transact with Covered FRFIs, since the substituted compliance that would be available under the Proposed Regulations would permit the local covered entity to rely on the Covered FRFI's model and margin calculations. This would, of course, put WUBS at a competitive disadvantage relative to Covered FRFIs and unable to serve such customers unless WUBS commits considerable resources to developing a model off of which its local covered entity counterparties can "piggy-back".

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please free to contact us at shannon.seitz@westernunion.com on this or any other issue in the future.

Sincerely,

Shannon Seitz
Legal Counsel, Custom House ULC

Scotia Plaza
100 Yonge Street
15th Floor
Toronto, ON M5C 2W1
Business.westernunion.ca