ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

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Delivered Via Email

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

Me Anne-Marie Beaudoin
Corporate Secretary
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Grace Knakowski
Secretary
Ontario Securities Commission
20 Queen Street West
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comments@osc.gov.on.ca

Dear Sirs/Mesdames:

The Canadian Bankers Association (**CBA**)[1] appreciates the opportunity to comment on the Canadian Securities Administrators' (**CSA**) Proposed National Instrument 93-102 *Derivatives: Registration*, which sets out a proposal for the regulation of key derivatives market participants through the implementation of a registration regime (the **Proposed Rule**).

The CBA strongly urges the CSA to exclude Canadian banks from the Proposed Rule, such that Canadian banks and their counterparties would not need to satisfy the conditions in, or be subject to the obligations under, the Proposed Rule. This exclusion would mitigate considerable negative implications for liquidity in Canadian over-the-counter (**OTC**) derivatives markets and preserve the ability of the Office of the Superintendent of Financial Institutions (**OSFI**) and other key policy-makers and regulators to oversee and manage prudential and systemic risks posed by banks' OTC derivatives activities. This exclusion is consistent with principles adopted by the International Organization of Securities Commissions (**IOSCO**) to encourage mutual recognition and cooperation among regulators. Further, this exclusion would align with Ontario's current approach to the Proposed Rule, thereby ensuring a measured, consistent and national approach to the regulation of the OTC derivatives market in Canada. Finally, as banks are already subject to comprehensive regulatory oversight with respect to each requirement under the Proposed Rule, this exclusion would not result in any gap in regulating banks' OTC derivatives activities.

<u>Negative Implications for Liquidity in Canadian Markets and End Users</u>

The OTC derivatives market plays a critical role in the financial services system and, more broadly, in economic growth across Canada. Small and large businesses, investment funds, and all levels of government and public sector entities require OTC derivatives to effectively manage risks in their operations. Pension funds also rely heavily on OTC derivatives to help meet their obligations to pensioners. OTC derivatives are also integral to the capacity of banks to hedge risk, perform treasury functions and carry out intermediary services, including supplying credit to businesses and individuals to support the economy.

While Canada represents only 4% of the global derivatives market, in excess of 80% of all trades with Canadian banks involve foreign counterparties, based on the notional amount. Put simply, Canadian markets require access to foreign dealers, but foreign dealers do not require access to Canadian markets. Bespoke requirements in the Proposed Rule and its broad territorial scope[2] will deter foreign dealers from participating in Canadian OTC derivatives markets. Even the most comprehensive substituted compliance regime would require foreign dealers to provide the CSA

[1] The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

[2] See the Canadian Market Infrastructure Committee (**CMIC**) letter, Schedule B. In addition to bespoke requirements, we note that as a result of the territorial scope of the Proposed Rule, a foreign bank that is dealing with a Canadian bank would be required to register and thereby be subject to these bespoke requirements in respect of all of its global trading. This expanded territorial scope will act as an additional deterrent to trading with Canadian banks.

with unfettered access to their books and records, which will be a considerable incentive for them to exit the market. Costs and liquidity premiums will be borne by clients, negatively impacting their earnings and diminishing returns to investors and pensioners. This will ultimately have a negative effect on the Canadian economy.

Moreover, because derivatives dealer registration will be separately imposed and enforced by each province and territory, if a market participant has only a few trades in a particular Canadian province or territory, the cost and increased regulatory risks associated with doing business in that jurisdiction will increase exponentially, such that it may not make commercial sense to do business in that jurisdiction. The result could be a highly fragmented marketplace where the availability and pricing of OTC derivatives products varies from one area of Canada to another, to the overall detriment of end users and the economies of smaller provinces and territories.

Excluding Canadian banks and their counterparties would mitigate the effect of these negative implications and ensure continued access to liquidity in OTC derivatives markets across Canada.

Fragmented Prudential Oversight

We are concerned that the Proposed Rule will undermine the capacity of OSFI and other bank regulators to manage prudential and systemic risks posed by Canadian banks. This will impede financial stability and thereby undermine the goal of global OTC derivatives reforms.

OSFI's supervisory mandate is housed within a broader regulatory framework that includes the Financial Institutions Supervisory Committee (**FISC**) and the Senior Advisory Committee (**SAC**). These committees ensure a coordinated and comprehensive approach among all the authorities at the federal level with responsibility for banks (e.g. Department of Finance, OSFI, Bank of Canada, Financial Consumer Agency of Canada and the Canada Deposit Insurance Corporation (**CDIC**)) to monitor and effectively respond to any prudential or systemic risks that may arise, with a view to ensuring that bank risks are identified and contained, and to promoting market stability and confidence. As illustrated during the financial crisis, this level of coordination was a significant Canadian advantage that was lacking in other jurisdictions.

As currently proposed, the Proposed Rule would allow the independent application of enforcement tools available to each securities regulator, including public disclosure of material prudential information regarding a bank and suspension and revocation of the bank's registration (which we believe could shut down the bank's global OTC derivatives trading if applied by the regulator in the bank's head office or principal place of business). Unlike OSFI initiatives, these steps would occur outside the FISC and SAC frameworks, would be uncoordinated with other Canadian OTC derivatives regulators, and could be taken by a single provincial regulator without regard to prudential or systemic risk implications.

In particular, we highlight the fundamental conflict between the obligation in certain circumstances to publicly disclose information under the mandates of provincial securities commissions and the requirements under the federal framework with respect to the confidentiality of bank supervisory information. The *Bank Act* and the *Supervisory Information (Banks) Regulations* provide that information relating to OSFI's supervision of banks is confidential in OSFI's hands and prescribed supervisory information is non-disclosable by banks. It is an offence to be in non-compliance with these rules. This conflict is exemplified by the very limited substituted compliance framework available to Canadian banks. This framework is unworkable, not only because it does not fully represent existing comparable OSFI standards, but also because it would require banks to disclose information to provincial regulators with no exception for supervisory information. Indeed, the information that banks may be required to disclose to the CSA go far beyond OTC derivatives trading data and include such sensitive prudential items as bank capital, minutes of board meetings and bank strategic planning.

The above concerns would be exacerbated during a bank recovery or resolution scenario. Bank recovery and resolution strategies mandated by OSFI and the CDIC assume continued access to OTC derivatives markets. Banks rely on these markets to hedge their risks in other bank activities and to maintain a balanced trading book. In addition, banks have taken great care to plan for continued access to these markets, including financial market infrastructure access and stays of termination rights during resolution. During a period of financial stress, a bank may experience capital or other stress that triggers provincial enforcement under the registration rule. A partial or global suspension of OTC derivatives trading would impede the ability of a bank to stabilize and restore financial strength and viability and frustrate efforts to unwind portfolios in an orderly manner, thereby increasing the potential risk of spreading contagion to Canadian and global markets. The Proposed Rule could also undermine CDIC's role as the resolution authority for banks and necessitate changes to OSFI's *Guide to Intervention for Federally Regulated Deposit-Taking Institutions* to reflect the role of the CSA.

Excluding Canadian banks from the Proposed Rule would avoid these dangerous risks and preserve the ability of banks' regulatory authorities to ensure effective prudential supervision.

<u>Restrictions on Trading with Individuals</u>

The Proposed Rule requires registered dealers who trade OTC derivatives with individuals who are not eligible derivatives parties (**EDPs**) to be Investment Industry Regulatory Organization of Canada (**IIROC**) dealers. This would effectively prohibit banks from trading OTC derivatives with individuals who are not EDPs. While trades with individuals represent a very small portion of banks' OTC derivatives trades, these trades are significant to certain businesses. For example, Canadian banks transact OTC derivatives with private banking clients in foreign jurisdictions through foreign branches. One CBA member estimates that half of the individuals that trade with it through this division would likely not meet the EDP threshold. In addition to OSFI oversight, these transactions are subject to and comply with local laws, which include requirements that individuals meet minimum financial thresholds and suitability assessments. This restriction would require Canadian banks in this situation to trade through a bank subsidiary that is an IIROC dealer member, which may not otherwise plan to register under the rules given that OTC derivatives are primarily traded through parent banks. The IIROC member would then be required to become licensed under local laws in the foreign jurisdiction. This places Canadian banks at a serious competitive disadvantage relative to our global peers. Excluding Canadian banks from the Proposed Rule would avoid this situation and ensure that banks can continue to provide these services.

Comprehensive Oversight of Banks' OTC Derivatives Activities

The Proposed Rule duplicates OSFI's robust regulatory regime which addresses all risks arising from banks' OTC derivatives activities. This regime has been effective in its oversight and has not been challenged as deficient. Schedule A to the CMIC letter details the breadth and depth of the current federal regulatory framework, and demonstrates that existing requirements that apply to Canadian banks meet the same objectives as the Proposed Rule on an outcomes-based analysis. In addition, the data in Annex A to this letter on a bank's OTC derivatives portfolio shows that the bank's client base is overwhelmingly institutional. This data, which is broadly representative of those Canadian banks that are global derivatives market participants, alleviates any policy concerns that individuals are not being adequately protected in the OTC derivatives market. As a result, excluding banks from the application of the Proposed Rule would not result in any gap compared to other market participants.

Context and Benefits of a Harmonized Approach

Exclusion of the Canadian banks from the Proposed Rule is consistent with principles adopted by IOSCO, which expressly recognizes that, where a designated market intermediary is subject to equivalent requirements by its prudential regulator, it should not be subject to registration or licensing.[3] In Hong Kong, for example, we understand that the Hong Kong Securities and Futures Commission's proposed licensing regime for OTC derivatives will exempt firms prudentially regulated by the Hong Kong Monetary Authority. In the US, CFTC Chairman Giancarlo has advocated that the CFTC operate on the basis of comity, rather than uniformity, with regulators that oversee comparable regimes.[4] Our proposal is grounded in a similar approach.

In the Canadian context, our proposed exclusion also aligns with historical efforts to achieve similar goals in Canada, including through various accords and memoranda of understanding between the provinces and OSFI, and through the Securities Dealing Restrictions in the *Bank Act*. Moreover, we note that Ontario has proposed to broaden the application of Section 35.1 of the *Securities Act* (Ontario) to exclude federally regulated financial institutions from derivatives dealer and adviser registration requirements. If an exemption comparable to Section 35.1 could be adopted as part of the Proposed Rule, it would result in a harmonized approach to derivatives regulation in Canada. A key benefit of the harmonized approach is that it has proven to be a highly effective model and has resulted in rationalization of scarce regulatory resources. In effect, this approach takes into account the fact that an institution that is already subject to an appropriate

[3] *International Standards for Derivatives Market Intermediary Regulation,* Final Report of the Technical Committee of the International Organization of Securities Commissions, June 2012 at page 13.
[4] https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo52?utm_source=govdelivery

level of regulatory oversight does not need to be subject to a duplicative second set of rules. As discussed in detail above, the application of a second set of rules gives rise to significant risks and complexities, without additional benefits. To our knowledge, the existing exemption approach has worked very well in Ontario for many years and would be a constructive model to replicate in the area of OTC derivatives regulation on a national basis.

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In closing, we reiterate our view that the Proposed Rule poses significant systemic and market risks for the Canadian OTC derivatives market, end users, and for the economy as a whole. To address these concerns, we are recommending a complete exclusion for Canadian banks. This exclusion would represent a harmonized approach to Canadian OTC derivatives regulation that is aligned with the current framework in Ontario. This approach would clarify regulatory responsibilities, minimize the risk of conflicts and complexities, avoid the costs and negative implications associated with imposing the rule, meet the public policy objectives of the CSA, and would result in a functional and consistent approach in this area.

In addition to these views, we endorse the submissions provided by CMIC and the International Swaps and Derivatives Association on the Proposed Rule and on Proposed National Instrument 93-101 *Derivatives: Business Conduct*. Thank you for considering our views on this important issue. Please do not hesitate to contact me with any questions you may have.

Sincerely,

Annex A
OTC Derivatives Portfolio Data

As of May 31, 2018	**In Canada**		**Outside Canada**	
Counterparty Type	**# Trades**	**Notional in USD**	**# Trades**	**Notional in USD**
Banks	4.46%	6.22%	13.95%	5.07%
Sovereigns	1.42%	3.04%	3.05%	1.66%
Investment Funds	6.46%	2.22%	9.66%	3.15%
Insurers	0.88%	0.73%	2.32%	1.12%
Pension Funds	1.10%	0.75%	1.78%	0.62%
Other Financials	3.06%	1.15%	29.09%	65.01%
Large and Small Corporates	10.44%	2.10%	12.28%	7.11%
Individuals	0.04%	0.00%	0.02%	0.04%
Totals	27.85%	16.22%	72.15%	83.78%