



BY EMAIL ONLY

February 1st, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Office of the Attorney General, Prince Edward Island
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Dear Sirs, Madams,

TMX Group Limited ("TMX Group") appreciates the opportunity to comment on National Instrument 24-102 Clearing Agency Requirements proposed "Joint Supplementary Guidance Developed by the Bank of Canada and Canadian Securities Administrators" with respect to recovery plans (the "Proposed Guidance"). TMX Group key subsidiaries include three key Canadian clearing facilities: the Canadian Depository for Securities Inc. (CDS) which supports Canada's equity, fixed income and money markets; the Canadian Derivatives Clearing Corporation (CDCC) which offers clearing and settlement services for all MX transactions and certain OTC derivatives, including fixed income repurchase and reverse repurchase agreement transactions and NGX which offers clearing and settlement services for natural gas, crude oil and electricity markets.

TMX Group is strongly supportive of a flexible and principles based approach to clearing agency requirements that are consistent with the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions ("CPMI-IOSCO") Principles for financial market infrastructures ("PFMIs"). TMX Group is concerned that prematurely imposing restrictions on a clearing agency during the recovery process may limit the ability of clearing agencies and other impacted market participants to resolve issues in a way that would be

optimal for all parties involved under the unique circumstances that led to recovery. As little foreign regulatory guidance in support of the CPMI-IOSCO guidance on Recovery of Financial Market Infrastructures (FMI) (the “CPMI-IOSCO Guidance”) has been published as of now, TMX Group urges the regulators to adopt recovery planning requirements closely aligned with the CPMI-IOSCO Guidance and ensure a level playing field between domestic and foreign clearing agencies operating in Canada. We have raised a number of more specific concerns below, but these themes generally appear throughout our comments.

General Comments

i. Principles Based Approach

Canadian clearing agencies today operate in an international marketplace which is subject to regulatory frameworks still evolving as regulators worldwide are also implementing the PFMI which govern the clearing agency requirements. The standards set by the PFMI support a principles based approach to regulation. TMX Group is supportive of this approach as it allows the rules, procedures, policies and operations of the clearing agencies to adapt and evolve over time. Though Canadian regulators have expressed their support to the principles based approach, TMX Group is of the view that the Proposed Guidance departs from this approach in some respects as its language and scope appear overly prescriptive even in comparison with the CPMI-IOSCO Guidance, which recognizes the diversity of FMIs and the circumstances that may give rise to the need for recovery, and refrains from placing limits on FMIs at the guidance stage.

ii. Level Playing Field Concerns

Foreign clearing agencies that are overseen by the Bank of Canada must also be subject to the Proposed Guidance. Section 1.1 of the Companion Policy to NI 24-102 states that “Annex I to this CP includes supplementary guidance in *text boxes* that applies to recognized domestic clearing agencies that are also overseen by the Bank of Canada”. The Proposed Guidance is found in Annex I. This suggests that recognized foreign clearing agencies will not be subject to the Proposed Guidance. Recently, EU regulators have further postponed the publication of their recovery guidance¹ and US authorities also have yet to publish guidance on the subject. In the CSA general responses to comments included in Annex B of the CSA Notice of Approval of NI 24-102, the CSA stated that a “recognized foreign-based clearing agency will only be exempted from requirements of the Instrument if it is subject to home regulation that achieves a similar outcome” and that “we do not believe that domestic clearing agencies are, or would be, at a competitive disadvantage by adhering to requirements in the Instrument that are similarly found in comparable international regulations”. As guidance from the regulators who oversee the foreign clearing agencies that operate in Canada has not yet been published and it is still

¹ Fresh Delay for EU Rules on CCP Spillover Losses, Risk Magazine, Cecile Sourbes, January 12, 2016.

quite uncertain what this guidance will look like in final form, clearly foreign-based clearing agencies will not be subject to home regulation achieving a similar outcome. Further, as the recovery guidance restricts clearing agencies' options while in recovery, and therefore their ability to recover, domestic clearing agencies will be at a competitive disadvantage if foreign clearing agencies are not subject to these requirements in Canada given they are not subject to these requirements in their home jurisdiction.

TMX Group believes that implementation of the Proposed Guidance should be delayed until US and EU regulators have finalized their guidance on the issue, at which point Canadian regulators will be in a better position to determine whether foreign clearing agencies are in fact subject to guidance that achieves a similar outcome. If they are not, foreign clearing agencies overseen by the Bank of Canada should also be subject to the NI 24-102 recovery guidance. Given the great deal of thought and discussion going into this issue internationally, we believe that Canadian market participants would also be better served by regulations that have benefited from the additional thoughts of the international community.

Authority of Action

i. Communication and Escalation Process

TMX Group and its clearing agencies, acting as FMIs, are entrusted with a public interest mandate and are committed to act in a way that would not jeopardize the Canadian financial stability when going into recovery. While TMX Group is cognizant that the use of any recovery tool may have serious implications for the broader financial system and is dedicated to staying in communication with the regulators before and throughout the recovery process, TMX Group is concerned that the Proposed Guidance language may suggest that the FMI should obtain prior approval before implementing its recovery plan or a specific tool, or be otherwise constrained by procedural requirements in times of stressed market conditions. During recovery, events may progress quickly and if prior approvals are constantly needed, a clearing agency may not be able to respond quickly enough to successfully manage the recovery.

Consultation with the regulatory authorities with respect to the use of the powers attributed to the FMI under its recovery plan should be made to the extent reasonably practicable only. TMX Group is of the view that the Proposed Guidance should only refer to a communication protocol to be agreed upon separately. Such communication protocol could circumscribe the steps that need to be taken before implementing a recovery tool and the timing of these steps, including the need to inform the regulators before implementing a tool within a set/agreed timeframe but excluding a prior approval requirement.

ii. Choice of Tools

TMX Group notes that the Proposed Guidance sets a clear distinction between recommended and non-recommended tools. TMX Group questions the strong stance that the Canadian regulators are taking in this regard giving that, as noted above, the international debate on such matter is still ongoing and the key guidance published to date, the CPMI-IOSCO Guidance, does not find any tools to be “not recommended”, but rather notes that many factors go into the determination of which tools or combination of tools would be appropriate for a given FMI under the circumstances. The CPMI-IOSCO Guidance describes multiple tools and also notes that their list was not intended to be exhaustive.

TMX Group is concerned that the Canadian regulators, by discouraging certain tools outright, might leave the Canadian FMIs less equipped to successfully manage their recovery, thus putting the Canadian marketplace more at risk than the international marketplace. To this end, TMX Group suggests softening the Proposed Guidance language found under “Tools not recommended for recovery plans” by qualifying such tools as “Other Tools” so as to ensure that the Canadian FMIs can develop, align and adjust their recovery plans flexibly in a way that will achieve optimal results for all market participants. We would also note that regulators should recognize that clearing agencies may need to make continued use of pre-recovery tools in combination with recovery tools which are in the recovery phase.

Tools and Characteristics

i. Incentives and Compensation

TMX Group acknowledges the importance of designing tools that create the appropriate incentives to encourage voluntary participation in recovery. TMX Group would give consideration to reimbursing participants for support received through a recovery process. However, we feel that the Proposed Guidance should adopt more flexible language as the decision to reimburse participants with post-recovery proceeds may also be subject to the FMI’s own credits agreements as well as applicable insolvency and corporate legislation. We would therefore suggest to modify the Proposed Guidance language from “This includes distributing post-recovery proceeds to participants that supported the FMI through the recovery process.” to: “This may include distributing post-recovery proceeds to participants that supported the FMI through the recovery process.” This would also be more consistent with the CPMI-IOSCO Guidance which does not mandate such mechanism.

ii. Legal Consideration for Full Allocation

TMX Group supports the regulators’ view that indirect participants that do not benefit from a customer protection regime only should be considered in the allocation of losses and shortfalls. As efforts currently underway on PFMI Principle 14: Segregation and Portability’s main objective

is to safeguard indirect participant assets and allow for a seamless transfer of positions and collateral in the event of default, it would seem counterproductive to adopt regulatory standards that would result in unintended consequences such as credit losses, to those indirect participants that elected to take advantage of available customer protection regimes. As increased utilization of the proposed customer protection standards is desirable for market stability considerations, TMX Group believes that imposing recovery tools on segregated indirect participants will act as a disincentive to the use of customer protection regimes offered to the Canadian marketplace.

iii. Variation Margin and Other Payment Haircutting

TMX Group is of the view that limiting the number of rounds of variation margin (“VM”) haircutting available to a FMI in the recovery process is overly restrictive and may result in undesirable consequences. VM haircutting is a transparent and measurable process from the perspective of FMI participants with the added benefit that FMI participants have control over their total exposure simply by closing out their own positions. Limiting the number of rounds available to a FMI while the FMI is attempting to re-establish a matched book may potentially result in larger cash calls vis-à-vis FMI participants if FMI efforts to re-establish a matched book fail. In the latter case, the exposure via cash calls may be capped, but is unmeasurable from a participant perspective, thereby adding additional uncertainty when managing through a crisis. The implementation of a cap, either based on time or amount, may undermine the effectiveness of VM haircutting which may lead to earlier implementation of other tools such as contract termination and is inconsistent with general international practice. This perspective is also supported by the CPMI-IOSCO Guidance which notes that this is a particularly powerful tool and does not even contemplate limiting the number of rounds of haircutting.

TMX Group recommends that the regulators consider payment haircutting more broadly than VM haircutting.² In some cases, VM haircutting offers little value for clearing agencies in recovery.³ For example, in the case of NGX, only a very small portion of their cleared volumes settle variation payments on a daily basis. Accordingly, it is highly unlikely that VM haircutting alone would be sufficient to satisfy a shortfall in financial resources. The majority of NGX's settlements are comprised of the receipt of payments for physical commodities delivered in the prior month. Haircutting such payments to clearing members would provide the most effective means of managing a financial resource shortfall.

TMX Group draws the regulators' attention to precedents in Canada and Australia for the use of payment haircutting in recovery situations.

² See discussion on “pro-rata payment obligations of CCP also known as PRO” described in ISDA, “CCP Default Management, Recovery and Continuity: A Proposed Recovery Framework” (January 2015).

³ This limitation to VMGH is acknowledged by CPMI-IOSCO in “Recovery of financial market infrastructures) (October 2014), ss. 4.1.5. and 4.2.21 (CPMI-IOSCO Guidance)

In Australia, where the ASX has proposed to replace VM haircutting with “Payment Haircutting” as a recovery tool, the ASX would use payment haircutting in situations where expected losses were to exceed default resources or where expected haircuttable payments owing by the FMI exceed expected payments that are to be received by the FMI.⁴

TMX Group also points to the case of CDS, where payment haircutting is used in the New York Link (“NYL”) default management waterfall to manage liquidity shortfalls of its NYL participants in extreme situations where a NYL participant has defaulted and the size of the loss exceeds the size of CDS’s bank liquidity facility. The payment haircutting is in place to cap what would otherwise be an infinite risk exposure to CDS. In the event of a default that exceeds CDS’s bank liquidity facility, CDS would allocate against surviving NYL participants as a haircut of their credits based on each NYL participant’s pro-rata share of total credits and then allocate the defaulter’s CAD credits to the surviving NYL participants.⁵

Conclusion

TMX Group appreciates the opportunity to provide comments with respect to the Proposed Guidance and looks forward to further dialogue on recovery tools and clearing agency requirements generally. We hope that you will consider our concerns and suggestions and would be happy to discuss these at greater length. Please feel free to contact Marlène Charron-Geadah, Legal Counsel, TMX Group at mcharron-geadah@m-x.ca if you have any questions regarding our comments.

Respectfully submitted,



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⁴ See ASX, “Central Counterparty Recovery: Consultation on Exposure Draft operating rules to implement loss allocation and replenishment tools for clearing participant default and non-default loss” *Public Consultation* (April 2015), p. 2429, s. V5, and related changes “ASX Recovery Handbook” applicable to ASX Clear and ASX Clear (Futures).

⁵ See Material Amendments to CDS Procedures. Amendments to Processing a New York Link Participant Default (Request for Comments) published on July 17, 2014 and approved by CDS’ recognizing regulators in September 2014. Also, CDS, “CDS Financial Risk Model” ver. 9.3 (January 2016), s. 8.4.4; CDS, “Participating in CDS Services” ver. 11.1 (November 2, 2015), s. 14.8.7; CDS, “CDSX Procedure and User Guide” ver. 11, (November 2, 2015), ss. 9.6 and 9.7.