



Canadian Market
Infrastructure Committee

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

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March 30, 2015

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators (“CSA”) Consultation Paper 92-401: Derivatives Trading Facilities (“DTF”) (the “Consultation Paper”)

INTRODUCTION

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

¹ CMIC was established in 2010, in response to a request from public authorities, to represent the consolidated views of certain Canadian market participants on proposed regulatory changes. The members of CMIC who are responsible for this letter are: 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, Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, 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, Public Sector Pension Investment 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

CMIC supports the efforts of the CSA to implement Canada's G20 commitment to mandate the trading of suitable OTC derivatives on exchanges or electronic trading platforms. The Consultation Paper sets out detailed background information on DTFs and related concepts, which was very useful in our consideration of the issues.

General Comments

As a preliminary point, while acknowledging Canada's G20 commitment, CMIC submits that it is critical to recognize the unique nature of the Canadian market, including its relatively small size and its limited liquidity, such that mandatory trading on DTFs may not be warranted, or may only need very limited scope. Mandating DTFs in Canada may, as a result, not be necessary. Taking such an approach in Canada is not inconsistent with Canada's G20 commitment to reporting and clearing of derivatives. However, if regulators believe that mandating DTFs is required, please see our answers to your questions below.

CMIC also submits it is important for regulators to consider developing an approach for foreign DTFs, such as Swap Execution Facilities ("**SEFs**") and Organized Trading Facilities ("**OTFs**"), that is built on substituted compliance with foreign jurisdictions, thereby creating an incentive for such foreign DTFs to service the Canadian market. Establishing bespoke regulation in Canada could well cause foreign DTFs to choose not to participate in the Canadian market, which would be harmful for maintaining access to global market liquidity by Canadian market participants.

In addition, as mentioned in our previous response letters, CMIC submits that the goal of harmonization among all provinces (including harmonization of the effective date), as well as with global derivatives regulation, is of utmost importance. Given the small size of the Canadian OTC derivatives market as compared to the global market, Canadian DTF rules should not conflict with global rules or place undue burdens on foreign DTFs, as that would put Canadian market participants at a competitive disadvantage. Certainly, Canadian DTF rules should not limit or restrict the ability of a DTF to comply with the SEF rules under the Dodd-Frank Act or the OTF rules under the European Market Infrastructure Regulation.

Another aspect of harmonization that CMIC supports is harmonization of DTF rules relating to governance with existing securities laws relating to alternative trading systems. As they are both trading facilities, the governance of each should be substantially similar.

It is also CMIC's view that the DTF rules should remain as flexible as possible, in particular with respect to execution methods, in order to easily adjust to changes over time in a product's liquidity. In particular, there should not be any uniquely Canadian rules that would impede trading on a foreign platform at the same time without compromising flexibility or harmonization with global protocols. It is important for Canadian rules to recognize the comparatively smaller Canadian market and the far more limited liquidity available in Canadian products.

All of these four concepts are elaborated upon below in our responses to the questions.

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 Canadian Securities Administrators, "CSA Consultation Paper 92-401 – Derivatives Trading Facilities" (2015), online: BCSC <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy9/PDF/92-401__CSA_Consultation_Paper__January_29__2015/>.

Responses to Questions in the Consultation Paper

Definition of “Derivatives Trading Facility”

1. Is the DTF category appropriately defined? If not, what changes are needed and why?

CMIC Response: CMIC is of the view that the definition should be amended by referring to “...a trading facility, platform or market...”. This would align the definition more closely with the definition of a SEF under the Dodd-Frank Act and, in our view, provide greater clarity. In addition, we suggest adding at the end of the definition, “and for greater certainty, does not include a single dealer platform.”

2. Is it appropriate to permit a DTF operator a degree of discretion over the execution of transactions? Why or why not? If discretion is permitted, should it be permitted only for trading in products that have not been mandated to trade on a DTF?

CMIC Response: It is CMIC’s view that DTF operators should be allowed a degree of discretion over the execution of transactions, whether or not the transactions are mandated to trade on a DTF, provided that such discretion is exercised in a manner consistent with the proposed best execution duty as discussed in our response to Question 8 below. In CMIC’s view, the following are examples of types of discretion that should be permitted for DTFs (provided that each client approves such discretion for its trades): when to place an order, which participants to contact for a request for quote (“RFQ”), which client orders or RFQs are matched with other client orders or quotes, order and timing of matching and how a trade is executed. Giving a DTF operator such discretions will provide flexibility in execution methods and also allow the DTF to source liquidity for a particular type of transaction.

Permitted Execution Methods

3. Is the description of permitted execution methods for a DTF suitable for facilities that currently offer or plan to offer trading in OTC derivatives?

CMIC Response: The description of permitted execution methods for a DTF are, in CMIC’s view, suitable for DTFs currently offering trading in OTC derivatives. However, we would hope and expect DTFs themselves to provide more insight in their answers to this question.

4. Please comment on required modes of execution. Should any particular minimum trading functionality be prescribed for DTFs generally?

CMIC Response: CMIC recommends that the CSA should not prescribe minimum trading functionality. Limiting trading to execution methods comparable to those used in the futures market, such as an order book system, rather than allowing for a variety of execution methods, is unlikely to be suited to the liquidity characteristics of the Canadian market and could attract high-frequency or predatory trading. CMIC strongly believes that a wide variety of execution methods be permitted, whether the transaction is mandated or not. As noted in Commodity Futures Trading Commission (“CFTC”) Commissioner J. Christopher Giancarlo’s White Paper³, “A swap product’s particular liquidity characteristics determine the execution technology and methodology, which can change over time” and therefore he suggests that this “liquidity continuum” necessitates flexible execution methods.⁴ CMIC supports Mr. Giancarlo’s view on this point.

³ J. Christopher Giancarlo, “Pro-Reform Reconsideration of the CFTC Swaps Trading Rules: Return to Dodd-Frank” (2015), online: CFTC <<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sefwhitepaper012915.pdf>>.

⁴ Giancarlo, *supra* note 3 at 26.

Regulatory Authorization of DTF

5. Is the proposed regulatory framework for DTFs appropriate?

CMIC Response: CMIC believes that DTFs are better-suited to respond to this question. However, to the extent that a Canadian uses a foreign DTF, that foreign DTF should not be required to register in Canada and comply with the proposed regulatory framework, provided such foreign DTF is subject to equivalent oversight in an approved jurisdiction. Allowing such an exemption on a jurisdiction-by-jurisdiction basis, rather than on an individual DTF basis, is the most efficient regulatory approach as it avoids the necessity of having every foreign DTF apply for an exemption. This is necessary in order for Canadian market participants to continue to have access to foreign DTFs and liquidity. CMIC anticipates that imposing such duplicate regulatory requirements may well cause foreign DTFs to restrict access to the Canadian market or actually disengage from the Canadian market.

6. Is it appropriate to impose dealer requirements on a DTF where the operator of the DTF exercises discretion in the execution of transactions? (Please explain.) If so, should such a DTF be required to register as a dealer, or should only certain dealer requirements be imposed on the DTF? (Which ones?)

CMIC Response: CMIC believes that DTFs are better-suited to respond to this question. However, to the extent that dealer requirements apply in the case of discretion, such requirements should not apply to a foreign DTF if the foreign DTF is subject to equivalent oversight in an approved jurisdiction.

7. To address conflicts of interest, should a DTF that exercises discretion in the execution of transactions be required to exercise this functionality in a separate affiliated entity? Why or why not?

CMIC Response: It is CMIC's view that requiring a DTF that exercises discretion to only do so in a separate affiliated entity is not necessary. CMIC submits that customary firewalls and internal conflict of interest policies should be sufficient measures to avoid conflicts of interest relating to the exercise of discretion.

8. What factors are relevant in defining the proposed best execution duty?

CMIC Response: CMIC recommends that the way in which the best execution duty is defined under National Instrument 23-101 *Trading Rules* is an appropriate way in which to define such duty for purposes of DTFs exercising discretion.

Organizational and Governance Requirements

9. Is it appropriate to allow a DTF to require clearing of all trades on the DTF that are capable of being cleared?

CMIC Response: CMIC does not believe that it is appropriate to allow a DTF to require clearing of all trades on the DTF that are capable of being cleared. If this were allowed, then a DTF could effectively establish a mandatory clearing policy. CMIC submits that it is inappropriate for a DTF to establish clearing policy and suggests that this duty rests with the regulators and not with DTFs.

10. Is it appropriate to allow a DTF to require transactions executed on its facility to be cleared through a particular clearing agency and/or reported to a particular trade repository?

CMIC Response: CMIC believes that a DTF should allow participant access to whichever clearing agency or trade repository (“TR”) such participant chooses. A DTF merely facilitates the transaction and should be limited to that role. Allowing a DTF to require transactions executed on its facility to be cleared through a particular agency would restrict the ability for market participants to use certain DTFs, if these DTFs don’t provide clearing capabilities to central clearing counterparties where they are clients or members. Such an approach could easily lead to decreased trading flexibility and increased operational costs of doing business.

11. Is it appropriate for a DTF that exercises discretion in trade execution to be permitted to limit access to its facility? If so, on what grounds should it be permissible?

CMIC Response: It is appropriate to allow a DTF to establish standards that must be met prior to a participant being allowed to trade on the platform. Examples of such standards include a requirement that a participant must have the minimum technical capability to trade electronically, and that a participant cannot engage in fraudulent or manipulative trading practices. Therefore, CMIC believes that it is appropriate for a DTF to have the ability to limit access. However, such standards should not include the credit worthiness of a participant. Ultimately, a DTF is not taking on the credit exposure of its participants and therefore a DTF should not limit access to participants based on credit worthiness.

12. Are the proposed organizational and governance requirements for DTFs appropriate? Are there additional organizational and governance requirements that the Committee should consider?

CMIC Response: CMIC believes that DTFs are better-suited to respond to this question.

13. Is it appropriate that a DTF that does not exercise execution discretion be permitted to perform its regulatory and surveillance functions itself, or should it be required in all cases to engage a third-party regulation services provider for this purpose? Please explain.

CMIC Response: CMIC believes it is appropriate that a DTF that does not exercise discretion be permitted to perform its regulatory and surveillance functions itself, provided it does not trade on its own behalf. Often, the DTF is in the best position to perform this function.

14. Do you agree with the proposal to prohibit DTF operators from entering into trades on their platforms as principals, on their own accounts? Please explain.

CMIC Response: CMIC agrees with this proposal. DTFs have access to all market data and trading information and it would be a conflict of interest for them to be engaging in proprietary trading within the same entity that has access to such information. Appropriate walls together with separation by legal entity should be required.

15. How should the sufficiency of a DTF’s financial resources be evaluated? Please comment on the methodology and frequency of the calculation.

CMIC Response: CMIC believes that the methodology and frequency of calculation of financial resources are matters that are best left to DTFs to provide commentary. However, we note that the Giancarlo White Paper⁵ points out that requiring a DTF to have financial resources in an amount that exceeds the total amount which would enable a DTF to cover operating costs for a one year period calculated on a rolling basis is inappropriate. This is the standard applicable to clearing agencies, and it is appropriate in the clearing context given the impact on the market if a clearing agency were to fail. However, if a DTF were to fail, there would not be a material impact on the market assuming there is more than one DTF for the particular products traded by the failed DTF. Giancarlo thus

⁵ Giancarlo, *supra* note 3 at 46.

argues that DTFs should be required to only hold financial resources sufficient to conduct an orderly wind-down of its operations, a view with which CMIC agrees.

Pre-trade Transparency

16. Should pre-trade transparency requirements apply to OTC derivatives that trade on DTFs but that have not been mandated to be traded on DTFs? If yes, what requirements should apply, and should any exemptions be provided?

CMIC Response: CMIC supports the CSA's goal of promoting pre-trade transparency and acknowledges the important benefits that may be realized through the disclosure of order information, including enhanced price discovery. At the same time, CMIC endorses the CSA's observation that enhanced pre-trade transparency may not actually achieve enhanced price discovery and agrees that it would be inappropriate to impose pre-trade transparency requirements for products that do not have sufficient liquidity to be mandated to trade on a DTF.

CMIC notes that the benefits of pre-trade transparency are generally associated with the order book model of execution, in which offers to purchase and sell derivatives products are made visible to all market participants with access to the order book. For liquid products traded via an order book, market makers will generally be willing to post offers to purchase and sell products on a continuous basis. The order book therefore assists with price discovery, insofar as it is possible for market participants to look at the order book and obtain an accurate sense of the current market price before they choose to interact with a particular market maker.

For illiquid product markets traded via an order book, however, the order book model may not always facilitate price discovery. Market makers will generally be less willing to post offers to purchase and sell securities on a continuous basis, and to the extent that such offers are posted, they will generally contain wider spreads in order to protect the market maker from downside risk. This means that the offers displayed in the order book may not reflect the best prices that a market maker is willing or able to provide, and market participants may need to look outside of the order book in order to find those prices.

While CMIC does not believe it would be appropriate for the CSA to require that bespoke or illiquid products be executed over a DTF, CMIC nevertheless supports the right of market participants to execute such products over a DTF on a voluntary basis. In these circumstances, however, CMIC does not believe that a DTF should be required to satisfy any particular disclosure requirements in order to enhance pre-trade transparency. As discussed above, mandatory pre-trade transparency would likely force a DTF into adopting an order book model that may not be appropriate given the illiquid nature of the product.

Rather, CMIC believes that market participants should be afforded the flexibility to select a DTF, execution model, and attendant levels of pre-trade transparency that are compatible with their particular circumstances. CMIC notes that this flexible approach is generally consistent with the CFTC rules, which do not impose any pre-trade transparency requirements for so-called "permitted transactions", which are not required to be executed using a SEF.

Post-trade Transparency

17. Are the proposed post-trade transparency requirements (involving real-time trade reporting as well as public reporting of certain daily data) appropriate for DTFs?

CMIC Response: CMIC also supports the CSA's efforts to promote post-trade transparency. However, CMIC has serious reservations around certain of the proposed measures to promote post-trade transparency, particularly the requirement for DTFs to make real-time public reports.

Under the CSA proposal, a DTF would be required to "report to the public transactions executed on the DTF in as close to real-time as technically feasible". CMIC notes that the CSA proposal is generally silent on the rationale for requiring a DTF to make real-time public reports, which is not at all obvious given that such reports will already be provided by a TR. Moreover, the CSA proposal is generally unclear on what type of information a DTF would be required to report to the public, and whether this would include the creation data reported to a TR by a reporting counterparty under OSC Rule 91-507 *Trade Repositories and Derivatives Data Reporting* ("**TR Rule**") (or the corresponding rule in other provinces), or a subset of the creation data reported to the public by a TR under the TR Rule, or alternatively some other set of information. CMIC submits that in order for market participants to properly evaluate the appropriateness of such public reports by a DTF, the CSA should provide greater clarity as to the type of information that the CSA contemplates a DTF disclosing.

To the extent that the CSA envisions a DTF reporting all or some of the creation data that is reported to a TR by a reporting counterparty, CMIC submits that such a reporting obligation should be harmonized to the fullest possible extent with public dissemination requirements applicable to TRs starting July 29, 2016. Further, CMIC submits that such a reporting obligation is not appropriate, as it does not appear to consider the mechanics of the clearing process or the separate reporting obligations of a clearing agency under the TR Rule. CMIC notes that a swap that is accepted for clearing – typically referred to as the "alpha" swap – is terminated immediately and replaced with two new swaps – usually known as the "beta" and "gamma" swaps. After the alpha swap has been terminated and replaced by beta and gamma swaps, the clearing agency becomes responsible for reporting these swaps in accordance with the reporting counterparty hierarchy in the TR Rule.

Because alpha swaps are terminated and replaced by beta and gamma swaps that are subject to full reporting by the clearing agency, CMIC submits that neither the DTF nor counterparties should be responsible for any reporting obligations in respect of alpha swaps. CMIC submits that there is little to no value in having DTFs report creation data for alpha swaps, whether through a TR or to the public directly, since they are almost immediately superseded by cleared swaps that are reported by the clearing agency. Requiring DTFs to make additional reports to the public would present negligible benefits with respect to post-trade transparency, as these reports would contain substantially the same information as the reports made by the clearing agency in respect of the gamma and beta trades.

In contrast to the minimal benefits provided by requiring a DTF to provide public reports, the costs of providing such reports would likely be high. This is highlighted by the experience of SEFs in complying with the reporting requirements in the U.S. Under CFTC rules, SEFs share responsibility for reporting alpha trades with Swap Dealers ("**SDs**")/Major Swap Participants ("**MSPs**"), with SEFs responsible for reporting the initial creation data and SDs/MSPs responsible for reporting the continuation data. These shared reporting rules have proven extremely challenging for SEFs to comply with, as they require a SEFs to report data that does not relate to execution, and thus is often outside of a SEF's possession. Moreover, SEFs and SDs/MSPs will frequently be connected to different Swap Data Repositories ("**SDRs**"), and thus will be incapable of sending data to the same location. This leads to issues of "orphaned" data, whereby part of a transaction may be reported to one SDR, and another part of the transaction may be reported to another SDR.

In order to avoid some of the difficulties that have arisen under the CFTC rules, CMIC submits that it is important that a single party be responsible for reporting a single swap transaction. For a transaction that is executed over a DTF and is subject to the clearing requirement, CMIC believes that the sole reporting party should be the clearing agency. Under CMIC's suggested approach, there

would not be a public report in respect of an alpha transaction; rather, a clearing agency would report the resulting beta and gamma transactions once the alpha transaction had been taken up for clearing. For an uncleared bilateral transaction that is not subject to a clearing requirement and that is executed over a DTF, CMIC submits that one of the counterparties to the transaction should be responsible for reporting, as determined by the reporting counterparty hierarchy under the TR Rule.

CMIC notes that such an approach is generally consistent with the reporting processes contemplated under the TR Rule, and thus will be able to leverage existing reporting infrastructures developed to comply with that rule.

18. What is the preferred method for real-time public reporting of transactions executed on a DTF (i.e., directly by a DTF, via trade repositories, or some other method)? What are the advantages and disadvantages of the proposed options?

CMIC Response: To the extent the CSA believes that additional public reports by a DTF are necessary, then CMIC strongly believes that such reports should be made indirectly through a TR, rather than directly by a DTF. Because there may ultimately be a number of different DTFs operating in the Canadian marketplace, requiring DTFs to disclose information to the public directly would mean that information would be fragmented across a number of venues, frustrating the ability of regulators and market participants to quickly and easily gain a complete view of the market. In addition, requiring DTFs to disclose information to the public directly may impair the quality of data, insofar as different DTFs may have different standards and practices for reporting.

19. & 20. When should deferred publication of trade information be permitted? Are there circumstances other than block trades? Assuming that deferred publication of trade information should be permitted for block trades, what criteria should be considered when determining the minimum block trade threshold size to permit deferred trade disclosure?

CMIC Response: As suggested in its response letter to CSA Staff Notice 91-302 *Updated Model Rules – Derivatives Product Determination and Trade Repositories and Derivatives Data Reporting*, CMIC is strongly of the view that the CSA's public reporting rules should provide for delays in the disclosure of large notional or "block" transactions. Disclosure of block transactions on an immediate or real-time basis may have a negative impact on the proper functioning of the market by impeding the ability of a dealer to hedge its risk exposures. For trades in illiquid products, a dealer will often require more time than T+1 to hedge its risk exposures. If the details of a transaction are disseminated to the public prior to a dealer having completed its hedge, the dealer may face increased costs in executing the hedge, since market participants can potentially trade against the dealer's position. These higher costs may either get passed on to end users in the form of wider spreads, or may deter dealers from participating in such transactions altogether, reducing liquidity in already illiquid product markets. Similarly, for trades in illiquid products, buy-side participants may seek to execute a large position by spreading the trade across multiple dealers. If details of a transaction are disseminated to the public prior to the buy-side participant having completed its trades, the buy-side participant may face increased costs in executing its trades since market participants can potentially trade against the buy-side participant's position.

CMIC submits that it is necessary for the CSA to adopt rules providing for delays in disclosure, comparable to those found in the U.S. Under CFTC rules, counterparties to transactions with notional values above certain minimum block sizes set by the CFTC will be permitted delays in reporting their transactions to the public. Formulating the appropriate thresholds for Canada can only be done after a significant study of trade reporting data in Canada.

21. What market information should a DTF be required to provide to the general public without charge, and on what schedule? Please be as specific as possible as to data elements, granularity, and schedule (compare with the U.S. CFTC rules in 17 CFR 16.01).

CMIC Response: In addition to real-time public reports, the CSA proposal suggests that DTFs would be required to provide “certain market information, to be determined by the Committee, to the general public at no charge on a delayed basis”. The CSA proposal indicates that a similar requirement exists under CFTC rules, where a SEF/Designated Contract Market (“**DCM**”) is required to make public “timely information on price, trading volume, and other trading data on swaps”. The required elements for publication by a SEF/DCM are set forth in 17 CFR 16.01.

As in the case of real-time public reporting, CMIC notes that the CSA proposal is generally silent on the rationale for requiring a DTF to separately publish information to the public on a delayed basis, when such information would presumably be available from a TR on a real-time basis. Again, the CSA proposal provides little colour on the information that would be published by the DTF on a delayed basis, making it difficult for market participants to evaluate the need for such reporting.

To the extent the CSA has patterned this requirement on the corresponding CFTC rules, CMIC submits that the CFTC rules may not, in this instance, provide an appropriate comparator. CMIC notes that there has been a longstanding requirement for DCMs to report such information under CFTC rules, and it is possible that the CFTC expanded this requirement to SEFs in order to minimize differences in treatment between SEFs and DCMs. Because the CSA regime does not contain a direct analogue to DCMs, CMIC does not believe that the consistency rationale would be applicable in the Canadian marketplace. Accordingly, CMIC strongly urges that the CSA consider deleting the requirement.

Provided the CSA determines that public reporting by a DTF on a delayed basis is necessary, CMIC believes that the information required to be reported by DTFs should be the same information as is required under the CFTC rules. Aligning the CSA’s disclosure requirements with the CFTC rules is in keeping with the general principle of harmonization, and would provide market participants with access to consistent data across the Canadian and U.S. regimes, facilitating comparison and analysis. It may also reduce the likelihood of certain manipulative trading practices, including the reverse engineering of a market participant’s positions, which may occur in the event there are gaps between the Canadian and U.S. disclosure requirements.

22. In addition to reporting trade information to a trade repository, should a DTF be required to disseminate trade information directly to all its participants, or only to the counterparties to the trade? Should there be a minimum amount of post-trade information that is disseminated to all participants, containing less detail than the information provided to the counterparties? Please specify.

CMIC Response: With respect to disclosure of transactional information to a DTF’s participants, CMIC does not believe that a DTF should be required to report information to its participants. On the contrary, CMIC suggests that the CSA adopt similar rules to those promulgated by the CFTC, which circumscribe the ability of a SEF to disclose transactional information to its participants.

Under CFTC Rules, a SEF is prohibited from disclosing transactional information to its participants *prior to* having reported that information to an SDR for dissemination to the public. Notwithstanding this prohibition, a SEF is permitted to make such information available to its participants *at the same time* as it reports to an SDR, provided that: (i) disclosure is made to the SEF’s participants only; (ii) the participants are given advance notice of such disclosure; and (iii) the disclosure is non-discriminatory (i.e. disclosure is made to all of the SEF’s participants). The prohibition against disclosure prior to reporting to an SDR is often referred to as the “embargo rule”, and is intended to

ensure that swap transaction and pricing data is disseminated uniformly and not in a manner that creates unfair competitive advantages for particular market participants.

As concerns regarding unfair competitive advantages and trading practices are equally salient in the Canadian marketplace, CMIC submits that a similar restriction on disclosure prior to public dissemination should be adopted. A requirement to send swap transaction and pricing data (for certainty, excluding information that may identify parties) to a DTF's participants simultaneously with the TR releasing such information pursuant to the TR's public disclosure obligations will reduce potential inequities between market participants, and will incentivize faster reporting to TRs. Notwithstanding that CMIC supports circumscribing a DTF's right to disclose information to its participants, it strongly believes that DTFs should be permitted to make such disclosure. Allowing the DTF's participants to see last trade information will generally enhance post-trade transparency and the price discovery process, and may potentially have positive effects from a liquidity perspective.

Trading Mandate

23. Are the proposed criteria for determining whether a derivative will be subject to a DTF-trading mandate appropriate? Should other criteria be considered?

CMIC Response: In CMIC's view, the CSA's proposed criteria for determining whether a derivative will be subject to a DTF trading mandate are appropriate. CMIC urges the CSA to consider the relative weighting of the criteria and suggests that some factors should be given more weight than others. For example, whether a derivative is liquid may be a more important factor than whether a derivative is trading on a SEF. Furthermore, each aspect of the criteria should be viewed as a separate determination. Whether a trade is mandated for clearing or not is separate and apart from a determination as to whether such trade should be required to go through a DTF, where a range of appropriate exemptions should be available. (See our answers to Question 25 below). To this end, CMIC submits that any class of derivatives required to be executed over DTFs must be first subject to an applicable clearing obligation as a condition precedent, regardless of the determinations made against the remaining criteria for that class of derivative.

Most importantly, CMIC endorses the co-operative consultative process with all Canadian regulators (noted by the CSA in Section 10(a) of the Consultation Paper) as being particularly valuable in the determination of which trades should be mandated for trading on DTFs.

24. Are there existing OTC derivatives that should be considered suitable for mandatory trading on a DTF? Are there classes of OTC derivatives for which a mandatory trading obligation would be detrimental to market participants?

CMIC Response: As mentioned in response to Question 23, CMIC submits that any class of derivatives required to be executed over DTFs must be first subject to an applicable clearing obligation as a condition precedent, regardless of the determinations made against the remaining criteria for that class of derivative. It is therefore very difficult for CMIC to comment on this without knowing which derivatives will be mandated for clearing. Further, there is very limited trade information available to determine liquidity. It is CMIC's view that this can only be determined once a significant amount of trade reporting data is available to the regulators and then studied to determine liquidity. Moreover, CMIC believes that since, for the time being, the regulators alone are able to see the aggregate trade reporting data, only the regulators are in a position to identify which derivatives should be mandated.

25. Are there any situations in which a product that has been mandated to trade exclusively on a DTF should be permitted to trade other than on a DTF? Should any category of market participants be exempt from a trading mandate?

CMIC Response: . With regard to the first part of this question, please see our response under Question 24. Also, CMIC submits that, to learn from problems encountered in other jurisdictions, Package Transactions should not be subject to mandatory trading on a DTF. A Package Transaction refers to a transaction involving two or more instruments:

- executed between two (or more) counterparties;
- priced or quoted as one economic transaction with simultaneous execution of all components;
- having at least one component that is subject to the DTF execution requirement; and
- where the execution of each component is contingent upon the execution of all other components.

A Package Transaction, as described above, includes at least one component which, on a standalone basis, would be subject to mandatory DTF execution. We submit that, when included as an integral part of a Package Transaction, such component (and the Package Transaction as a whole) should not be subject to mandatory execution on a DTF. Taking our recommended approach should not be an impediment to foreign platforms seeking to be recognized, or seeking an exemption from recognition, in Canada if Package Transactions are treated differently under foreign rules applicable on such foreign platforms.

Imposing the DTF execution requirement on individual components which are part of a Package Transaction would result in increased costs and risks to market participants. Trading the components of a Packaged Transaction separately and on different venues (i.e. partly on and partly off a DTF) can result in higher costs and greater risks due to timing differences, with the possibility of the market moving between the execution of each component, and differences in transaction specifications, mode of execution, clearing/settlement workflows and relative liquidity, as compared to simultaneous execution using a single execution method.

If a component of a Package Transaction is required to be separately executed on a DTF, the increased cost and risk could render the transaction uneconomic. This negative outcome is not outweighed by price transparency considerations, since the pricing of a component traded as part of a Package Transaction may not be comparable to the pricing of the same type of transaction on a standalone basis.

With respect to the categories of market participants that should be exempt from a trading mandate, it is CMC's view that an end-user exemption should be available, and that the exemption should align with the end-user exemptions under the mandatory clearing rule. In addition, CMIC supports an inter-affiliate exemption from mandatory trading on a DTF. Subjecting inter-affiliate OTC derivatives to mandatory DTF execution requirements would impose unnecessary costs and impede the efficient transfer and management of risks among affiliates, without any discernible benefits. Execution through an RFQ system would not be efficient for inter-affiliate transactions, since RFQ recipients affiliated with the requestor could not be counted toward the minimum number of recipients, while execution through an order book would not ensure that the affiliates' trading interest is matched. The benefits of DTF execution in terms of promoting price discovery are not compelling in the case of inter-affiliate trades, since competitive pricing is not necessarily a primary objective in inter-affiliate transactions.

26. Should there be a formal role for DTFs in initiating the process to specify that a class of OTC derivatives is mandated to trade exclusively on a DTF, comparable to the role of SEFs in the MAT process described on page 19?

CMIC Response: As mentioned in our response to Question 24, it is CMIC's view that the regulators alone should determine which derivatives should be required to trade on a DTF and therefore we do not believe that a DTF should have the power to make such determination. CMIC notes that DTFs will always have the ability to provide commentary on proposed trading mandates along with the rest of the public. Further, we note the "made available to trade" ("**MAT**") determination process under CFTC rules (whereby a SEF may submit a MAT determination for products to be mandatorily traded on a SEF and the CFTC may only deny the submission if it is inconsistent with the Commodity Exchange Act or CFTC regulations) has come under criticism. As noted in the Giancarlo White Paper,⁶ the MAT process is problematic because it may force swaps to trade through a limited number of execution methods even where those swaps lack the liquidity needed to support such trading. Moreover, in the U.S., because the MAT process is controlled by SEFs, a relatively new SEF could gain a first-mover advantage by forcing a particular product to trade through restrictive methods of execution on the SEF. In other words, the decision of one platform could bind the entire market.⁷

27. What pre-trade transparency requirements are appropriate for OTC derivatives that have been mandated to be traded on a DTF? In particular, what precise pre-trade information should a DTF be required to publish for OTC derivatives that are subject to a DTF-trading mandate? Please be specific in terms of the execution method (e.g., order book, RFQ, etc.).

CMIC Response: CMIC does not believe that the CSA should be prescriptive in requiring pre-trade transparency requirements. It is CMIC's view that imposing pre-trade requirements would reduce liquidity and reduce flexibility with respect to execution methods.

28. For the purpose of exempting large orders and quotes from pre-trade transparency requirements or permitting modified disclosure, how should an appropriate size threshold be determined?

CMIC Response: CMIC submits that such thresholds will need to be determined in conjunction with public dissemination requirements applicable to TRs starting July 29, 2016. A thoughtful review based on a proper analysis of Canadian market data over an extended period of time is necessary to determine the appropriate approach to public dissemination of trade information for the Canadian market. This analysis of Canadian market data can be done only by the regulators, as they alone have access to market-wide data via the TR. Further, this type of analysis will require the assessment of competitively sensitive data, such as block trade data and participant concentrations. Once regulators have performed this analysis after a sufficient period of reliable data is available through trade reporting and determined an approach to public dissemination of trade information, market participants should be consulted. It is CMIC's view that firms acting as market makers would be negatively impacted by regulators adopting in Canada the same thresholds and caps that exist under CFTC rules, given that most instruments in Canada are not as liquid as in the U.S. Market makers would be negatively impacted if the data could be manipulated to conclude that a specific transaction had been executed. This would impair the ability to manage risk which would adversely affect market liquidity, widen bid-offer spreads, reduce efficiency or make the trade not viable. End users looking for hedging solutions would be adversely impacted as a result.

29. Is it appropriate to limit trading in OTC derivatives that have been mandated to be traded on a DTF to specific permitted execution methods, e.g., an order book, or a request-for-quote system offered in conjunction with an order book? Why or why not? If so, which modes of execution should be permitted for products that are mandated to trade on a DTF? Can an appropriate level of pre-trade transparency be achieved with other methods of execution? What other factors should be considered?

⁶ Giancarlo, *supra* note 3 at 29.

⁷ Giancarlo, *supra* note 3 at 30.

CMIC Response: As mentioned, it is CMIC's view that the CSA should adopt a flexible approach to execution methods. As noted in the Giancarlo White Paper,⁸ the markets would be best served by not limiting trading to specific execution methods. Providing flexibility will allow markets to develop "rationally and organically"⁹ as a result of specific product characteristics and liquidity profiles. Further, it would allow execution methods to be tailored to the liquidity characteristics of the specific swap product.

30. What additional requirements should apply to DTFs with respect to trading in products that have been mandated to trade on a DTF?

CMIC Response: It is CMIC's view that the CSA should consider including the concept of clearing certainty within their DTF rules to allow for greater market access, impartial access and usage of the platform. Market participants executing Intended to be Cleared ("ITBC") swaps on a DTF should not be exposed to unnecessary market risk as a result of processing latency outside of their direct control or credit breaches at the clearing agency or their clearing broker.

The CFTC brought much clarity to the marketplace through the issuance of a number of policy statements, such as clearing agencies are required to accept or reject trades submitted for clearing within 10 seconds and that any ITBC swaps that are executed on a SEF and that are not accepted for clearing should be void ab initio (as if it never existed). The CFTC required SEFs to have rules to this effect.

Clearing certainty requires the necessary Straight-Through Processing ("**STP**") framework and the operational framework to resolve rejected ITBC trades due to operational errors. The absence of this framework introduces risk into the system. The necessary STP framework should include a pre-trade credit check to ensure that a bona fide trade is executed on a DTF, an executed trade on a DTF should be sent electronically to the clearing agency and the clearing agency response in turn should accept or reject the trade within 10 seconds. There are some cases where STP may not be feasible (trades executed off-DTF) that are then subsequently entered on the DTF, or package trades where one component is on a DTF and another leg is executed off-DTF, requires careful consideration within this framework. An operational framework that does not deal with trades that are rejected from clearing due to clerical or operational reasons creates additional market and execution risk, if there is no opportunity to re-submit the trade. After a market participant executes a swap, the participant hedges its risk with other swaps. If the swap is declared void and the participant has no opportunity to resubmit, the participant will not be correctly hedged and left with facing unwanted market direction and/or execution risk.

General

31. Please describe any specific characteristics of the Canadian OTC derivatives markets that the Committee should consider, which might justify a divergence between Canadian rules and those in effect in the U.S. and the E.U. Please consider transparency requirements, the trading mandate, and anything else you think relevant. Please refer to specific consequences of the characteristics you identify.

CMIC Response: The Canadian market, relative to the global market, is very small with limited liquidity. It is CMIC's view that the regulators should evaluate the Canadian OTC derivatives market over a period of time after a sufficient period of receiving reliable trade reporting data so that the regulators can carefully consider whether DTF rules are necessary in Canada and what those rules should be. If this is the case, we do not believe it is economical nor beneficial to take the time to

⁸ *Ibid* at 31.

⁹ *Ibid*.

develop DTF rules if there will not be any trades with sufficient liquidity to be mandated to trade on a DTF. It would be unfortunate and counterproductive to formulate DTF rules in Canada that deter foreign SEFs from participating in the Canadian market.

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:

- 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
- Deutsche Bank A.G., Canada Branch
- Fédération des Caisses Desjardins du Québec
- 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
- Public Sector Pension Investment Board
- Royal Bank of Canada
- Sun Life Financial
- The Bank of Nova Scotia
- The Toronto-Dominion Bank