Central 1®

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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

c/o

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Dear Mesdames:

This letter is in response to Proposed National Instrument 94-101 Mandatory Central Counterparty Clearing of Derivatives and Proposed Companion Policy 94-101CP Mandatory Central Counterparty Clearing of Derivatives (collectively, the "Proposed National Instrument"). We thank the OTC Derivatives Committee (the "Committee") for its consideration of our submission on CSA Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (the "Draft Model Rule"). The comments below build upon our position in that letter.

Central 1 Credit Union ("Central 1") is the central financial facility, liquidity manger, payments settlement centre, and trade association for all credit unions in British Columbia and its member credit unions in Ontario. Central 1's active member credit unions, which number 43 in B.C. and 84 in Ontario, deliver a wide range of financial services to more than 3.2 million members.

Central 1®

The Unique Central 1-Credit Union Relationship

Credit unions engage in OTC derivatives for hedging purposes and Central 1 is the primary counterparty in OTC derivatives to its member credit unions. It holds liquidity reserves of its member credit unions and also holds a general security agreement (GSA) with each member. These GSAs include a first claim on assets in the event of liquidation of a credit union. Thus, in the highly unlikely event of a credit union failure, Central 1 as the OTC counterparty would be made whole because of its relationship with the credit union. Derivatives transactions between a credit union and its central represent no external risk to third parties.

The dual public policy objectives of (1) encouraging prudent market participation and (2) reducing exposure and risk of failure are at the forefront of Central 1's recommendations below.

Intragroup and End-User Exemptions

In its present form, neither the end-user, nor the intragroup exemption applies to the special relationship between Central 1 and its credit unions.

Central 1 notes that the Committee did not accept the recommendation that the end-user exemption be extended to small financial entities such as credit unions and instead deferred to the proposed *Phase-in of the requirement to clear a mandatory clearable derivative*. While we appreciate that smaller financial entities would not be required to clear for at least six months following implementation, we urge the local regulators to extend the policy rationale for this decision to a permanent exemption. Please see our comments below on the *de minimus* exemption.

Similarly, Central 1 is disappointed that the Committee did not recommend a change to allow the intragroup exemption to apply to credit unions and their Centrals. The intragroup exemption is worded ambiguously, indicating that the entities must be "prudentially supervised on a consolidated basis". We note the explanatory table notes "prudentially supervised" can refer to a regulator other than the Office of Superintendent of Financial Institutions, but it is not clear if the "consolidated basis" requirement applies to the same or similar regulators. For example, Central 1 is regulated in British Columbia, but provides services to its member credit unions in Ontario, which are regulated solely by Ontario.

De minimus Exemption

As noted in our past submission, we continue to believe that the Committee should implement a *de minimus* exemption. From a public policy perspective, implementing such an exemption would continue to protect Canadians from systemic market risk, while continuing to encourage prudent, healthy and productive hedging by smaller entities.

In our discussions with our provincial regulators, Central 1 explored a traditional "belt and suspenders" approach that we feel would best satisfy this policy objective. An exemption based on both size and exposure would ensure that small organizations are not overly burdened by clearing requirements, while still capturing any outliers (i.e. unusual situations where small entities were engaging in high levels of OTC derivatives activity).

As such, Central 1 proposes that institutions below $5 billion in assets should qualify for a *de minimus* exemption, which currently comprises 73.2% of the system assets nationally[1]. Presently, the aggregate gross notional exposure (GNE) of Canadian credit unions with assets over $5 billion is $999 million, whereas the GNE of credit unions over $10 billion is $630 million.

In addition, as an institution holding $13.1 billion in balance sheet assets that provides services to more than 300 credit unions and institutional clients, all of the OTC transactions conducted by Central 1 on its own behalf with other capital market participants would continue to be subject to mandatory clearing. Thus, combining these tools would capture the bulk of trading activity in the Canadian credit union system outside Quebec.

Conclusion

In closing, Central 1 would be pleased to provide the Securities Administrators with any additional information as may be required in consideration of comments provided above.

Should you have any questions please do not hesitate to contact me at cmilne@central1.com or by telephone at 604-730-6307.

Yours truly,

Charles Milne
Chief Investment Officer
Central 1 Credit Union

cc

Don Wright, President and CEO, Central 1 Credit Union

Martha Durdin, President and CEO, Credit Union Central of Canada

Carolyn Rogers, President and CEO, Financial Institutions Commission, British Columbia

Andy Poprawa, President and CEO, Deposit Insurance Corporation, Ontario

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[1] Outside of Quebec.