Canadian Market
Infrastructure Committee

Confidential

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Alberta Securities Commission
Autorité des marchés financiers
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

December 19, 2017

Dear Sirs/Mesdames:

Re: Proposed Amendments (the "Proposed Amendments") to National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* ("NI 94-101") and Related Companion Policy (the "Companion Policy")

INTRODUCTION

CMIC is pleased to provide this comment letter on the Proposed Amendments.

CMIC was established in 2010, in response to a request from Canadian public authorities,[1] to represent the consolidated views of certain Canadian market participants on proposed regulatory and legislative changes in relation to over-the-counter ("**OTC**") derivatives. The members of CMIC who are responsible for this letter are: Bank of America Merrill Lynch, Bank of Montreal, Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch, Caisse de dépôt et placement du Québec, Canada Pension Plan Investment Board, Canadian Imperial Bank of Commerce, Citigroup Global Markets Inc., Deutsche Bank A.G., Canada Branch, Fédération des Caisses Desjardins du Québec, Healthcare of Ontario Pension Plan Trust Fund, HSBC Bank Canada, Invesco Canada Ltd., JPMorgan Chase Bank, N.A., Toronto Branch, Manulife Financial Corporation, Morgan Stanley, National Bank of Canada, OMERS Administration Corporation, Ontario Teachers' Pension Plan Board, Royal

[1] "Canadian public authorities" means representatives from Bank of Canada, Canadian Securities Administrators, Department of Finance and The Office of the Superintendent of Financial Institutions.

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 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, but not limited to, both domestic and foreign owned banks operating in Canada as well as major Canadian institutional market participants (including a number of major pension funds) in the Canadian derivatives market. This letter reflects the consensus of views within CMIC's membership about the proper Canadian regulatory and legislative regime applicable to the OTC derivatives market.

GENERAL COMMENTS

CMIC is supportive of the main policy objective of the Proposed Amendments to effectively exclude trusts and investment funds from the clearing requirement. While we believe the Proposed Amendments accomplish this stated objective, we wanted to highlight for your consideration some of what we anticipate may be unintended consequences of the current drafting.

AMENDING THE DEFINITIONS OF AFFILIATES AND CONTROL

We note that the Canadian Securities Administrators (the "**CSA**") have taken the approach of excluding trusts and investment funds from the clearing requirement by excluding them from Sections 3(1)(b) and (c) of NI 94-101. By taking this approach, rather than excluding them from the affiliate and control provisions under Sections 1(2) and (3), the ISDA Canadian Clearing Classification Letter[2] (the "**Classification Letter**") will need to be amended, in particular in respect of the definition of "Exempt Entity" in the Classification Letter. The Classification Letter allows market participants to provide their counterparties with status information in order to determine if they are in scope for purposes of NI 94-101. This risks confusing foreign market participants who, in our view, will already be reluctant to complete the letter. If, however, sections 1(2) and (3) of NI 94-101 were amended instead[3] of Sections 3(1)(b) and (c), the Classification Letter would not need to be amended as it incorporates the term "affiliate" and "affiliated" as defined in NI 94-101. Changes to the Classification Letter will result in delaying client outreach efforts until the Proposed Amendments have been finalized.

NARROWING OF THE EXEMPTION UNDER S. 3(1)(C)

In CMIC's view, the changes to Section 3(1)(c) appear to narrow the number of market participants that would otherwise have been in scope prior to the Proposed Amendments, by effectively creating a new exemption by adding Section 3(1)(c)(iv). This new provision exempts from the clearing requirement a local counterparty that is a member of a group whose gross notional amount of outstanding derivatives exceeds $500 billion (excluding inter-affiliate trades) but itself does not exceed $1 billion in gross notional amount. This could permit, for example, a pension fund that is not a clearing member but is over the $500 billion threshold to incorporate a new

[2] Available at: https://www.isda.org/2017/03/30/canadian-clearing-classification-letter/.

[3] CMIC submits that such amendment would clarify that trusts and investment funds are not considered affiliates of another person even if the trustee of such trust or fund is controlled by, or controls, such other person, or they are controlled by the same person.

subsidiary, or several subsidiaries, which would not be required to clear as long as each subsidiary remains below the $1 billion threshold. Mandatory clearable derivatives entered into by such subsidiary with another entity in scope under Section 3(1) would not be required to be cleared. However, if instead the pension fund itself entered into such mandatory clearable derivative, such a transaction would need to be cleared based on the facts in our example. CMIC is not opposed to the creation of this additional exemption but simply wanted to point out the effect of the Proposed Amendments.

If the CSA's intent was simply to exclude from Section 3(1)(c) affiliates of participants referred to in Section 3(1)(a) since they are already in-scope under Section 3(1)(b), CMIC submits that the more effective way to do this would be to delete Section 3(1)(c)(iv) and re-word Section 3(1)(c)(i) as follows:

> (c)(i) is a local counterparty in any jurisdiction of Canada, other than an affiliated entity of a participant referred to in paragraph (a).

LACK OF HARMONIZATION WITH OTHER RULES

CMIC notes that the definitions of "affiliated entity" and "control" in Sections 1(2) and (3) of NI 94-101 are very similar to those definitions in Sections 1(3) and (4) of Quebec Regulation 91-507 ("**Quebec 91-507**") and Sections 1(2) and (3) of Multilateral Instrument 96-101 ("**MI 96-101**"). It is therefore inconsistent to have a carve out or clarification for trusts and investment funds in NI 94-101, but not in Quebec 91-507 or MI 96-101. Otherwise, an inference could be created to the effect that these reporting rules require trades between a bank and its managed funds and trusts to be reported as inter-affiliate trades. In CMIC's view, this would be very undesirable as it is inconsistent with how these provisions are currently being interpreted by market participants. In addition, we believe such an inference would be contrary to Ontario Securities Commission Rule 91-507 and Manitoba Securities Commission Rule 91-507, which have more restrictive language regarding affiliates under Sections 1(2) and (3) of the *Securities Act* (Ontario).

Accordingly, while CMIC supports the exclusion of trusts and investment funds from the clearing requirement by excluding them from the definitions of affiliate and control under NI 94-101, we strongly support changing the wording of the CSA notice and the related Companion Policy to provide that the Proposed Amendments are interpreted as only being made to remove any risk that trusts and investments funds are included in the definition of "affiliates" and "control" under NI 94-101. We also highlight the need for ongoing efforts to harmonize these defined terms across all Canadian OTC derivatives rules.

TIMING OF CALCULATION OF THRESHOLD

As currently drafted under Sections 3(1)(b)(iii) and (c)(iii), the calculation of month-end gross notional amount is required to be performed "at any time after the date on which [the] Instrument comes into force". This means that if a counterparty referred to in Section 3(1)(b) or 3(1)(c) happened to exceed the applicable threshold only in respect of one month subsequent to the instrument coming into force, it would forever be required to clear OTC derivatives under NI 94-101. For example, such a counterparty may have exceeded the applicable threshold in April of 2017 (which is the month the instrument came into effect), but by August of 2018 (when mandatory clearing for such counterparties is scheduled to commence), 16 months later, such counterparty may be below the applicable threshold. CMIC submits that such a

counterparty would not be systemically important and therefore, should not be required to forever clear OTC derivatives under NI 94-101. It is CMIC's view that the clearing requirement should be applicable under Section 3(1)(b) and (c) only if the applicable thresholds are exceeded at the time the relevant clearable derivative is entered into (subject to Section 3(2)). However, for operational purposes, instead of potentially testing these thresholds on any day, CMIC submits that these thresholds should only be tested annually, similar to the annual testing of the $12 billion threshold under OSFI Guideline E-22 Margin Requirements for Non-Centrally Cleared Derivatives and CSA Consultation Paper 95-401 Margin and Collateral Requirements for Non-centrally Cleared Derivatives. Take, for example, a counterparty that exceeds the threshold and is subject to the mandatory clearing mandate. If the counterparty falls below the clearing threshold during that year, that counterparty would still be required to clear in-scope transactions until the next annual testing of the threshold and must be below the threshold on the testing date to no longer be subject to the mandatory clearing mandate. CMIC therefore recommends that Sections 3(1)(b)(iii) and (c)(iii) should be amended accordingly.

CMIC recognizes that this comment is unrelated to the Proposed Amendments, however, the fact that the clearing requirement for counterparties under Sections 3(1)(b) and (c) has been delayed until August 2018 highlights this issue given the length of time that will have passed since the date on which the instrument came into force and the date on which mandatory clearing will become effective for these counterparties.

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 America Merrill Lynch
Bank of Montreal
Bank of Tokyo-Mitsubishi UFJ, Ltd., Canada Branch
Caisse de dépôt et placement du Québec
Canada Pension Plan Investment Board
Canadian Imperial Bank of Commerce
Citigroup Global Markets Inc.
Deutsche Bank A.G., Canada Branch
Fédération des Caisses Desjardins du Québec
Healthcare of Ontario Pension Plan Trust Fund
HSBC Bank Canada
Invesco Canada Ltd.
JPMorgan Chase Bank, N.A., Toronto Branch
Manulife Financial Corporation
Morgan Stanley
National Bank of Canada
OMERS Administration Corporation
Ontario Teachers' Pension Plan Board
Royal Bank of Canada
Sun Life Financial
The Bank of Nova Scotia
The Toronto-Dominion Bank