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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22^e étage
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Montréal (Québec) H4Z 1G3

Dear Sirs / Madames:

RE: Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada

Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada ("CP 91-401") related to enhancing the regulatory framework of the Over-the-Counter ("OTC") derivatives markets in Canada.

Fidelity Investments Canada ULC ("Fidelity Canada") is the 6th largest fund management company in Canada and part of the Fidelity Investments organization in Boston ("Fidelity Investments"), one of the world's largest financial services providers. Fidelity Canada manages a total of \$64 billion in mutual funds and institutional assets (the "Funds"). It offers approximately 140 mutual funds or pooled funds to Canadian investors.

Fidelity Canada's use of OTC derivatives currently includes currency forwards to hedge currency risk in certain Funds, interest rate swaps for the purpose of managing fixed income portfolio duration, and customized forwards in the Fidelity Corporate Bond Capital Yield Class and the Fidelity Premium Fixed Income Capital Yield Private Pool ("Capital Yield Funds"). The Capital Yield Funds invest primarily in equity securities issued by Canadian corporations and enter into forward contracts in order to hedge their exposure to the equities and provide the Fund with a return based on the performance of a Canadian fixed income fund managed by Fidelity Canada.

Fidelity Canada's responses to the questions in CP 91-401 are noted below:

A. CLEARING

1. *Do you agree with the recommendations on the approach to implementing mandatory central clearing? What factors should be taken into consideration by regulators in identifying OTC derivatives appropriate for clearing and which are capable of being cleared?*

Response:

Fidelity Canada currently manages counterparty risk through an on-going risk assessment process that is managed by a dedicated counterparty analysis group within Fidelity Investments. Counterparty risk for the Funds that are mutual funds is also governed by National Instrument 81-102 ("NI 81-102") such that Fund counterparties must have an "approved credit rating", as defined in NI 81-102, and exposure to any one counterparty on a mark-to-market basis is restricted to no more than 10% of the net assets of a Fund. Though Fidelity Canada believes counterparty risk and exposure is effectively mitigated by these NI 81-102 requirements, Fidelity Canada is generally supportive of the proposed implementation of mandatory central clearing for the purpose of applying standardized risk models, realizing legal and operational efficiencies, and reducing market exposure through multi-lateral netting.

However, mandated centralized clearing is likely to result in increased costs to the Funds, especially those which use OTC derivatives to hedge risk as part of their fundamental investment objective. For example, certain Funds use OTC currency forwards to hedge currency risk. Since membership in a central counterparty clearing house ("CCP"), or access to a CCP through a financial intermediary will likely require the payment of a fee and/or contribution to a contingency fund, as well as the maintenance of minimum margin requirements, this use of Fund capital and/or increased operating expenses would reduce investor returns and significantly alter the structure of the affected Funds. As such, it is important to assess the cost impact of mandatory centralized clearing on each type of derivative instrument relative to their use and, if appropriate, consider whether an end-user exemption might be appropriate.

Technical factors to include in the assessment of OTC derivatives appropriate for clearing include: an assessment of the liquidity of the underlying asset as well as the liquidity of the market for the derivative, the degree of contract standardization in the OTC market and the expected impact of standardization on the use of the derivative by market participants, and the risk profiles of market participants, including whether the market participant is subject to other regulatory requirements designed to mitigate counterparty risk.

2. *What is your view on possible solutions for accessing CCPs and allowing for the most efficient use of capital? Considerations should account for risk models, collateral netting, membership criteria, etc. Possible iterations are, but are not limited to:*

a) *Creation and Use of Canadian Multi-Asset CCP*

Response:

Fidelity Investments is a global asset manager, and while it is important that Canadian regulatory authorities have access to information that assists in assessment of derivative risk in the Canadian market, the global nature of the OTC derivatives market suggests that a Canadian CCP solution may not be optimal relative to managing risk, cost and liquidity for Canadian market participants.

In order to fully realize economies of scale for market participants, and achieve meaningful liquidity and risk mitigation, a Canadian clearinghouse may not be the most effective way of achieving these objectives. Should the counterparty risk models, capital requirements and costs of participating in a Canadian CCP solution not be competitive with those in other markets, this is likely to have a negative impact on liquidity in the Canadian market as participants seek more effective solutions in other countries. As such, while Fidelity Canada supports the need for Canadian regulatory authorities to monitor derivative trading and open interests, the viability of a Canadian CCP should be considered in light of regulatory and market developments in other countries.

b) *Accessing Global Single and/or Multi-Asset CCPs, with additional collateral requirements for non-cleared trades not available for clearing globally*

Response:

Due to the global nature of the OTC derivatives market, Canadian market participant's ability to access global single or multi-asset CCP's with sustained (and sustainable) liquidity, structural efficiency and risk management expertise are best suited to function as a CCP for OTC derivatives. However, to the extent Canadian regulatory authorities might experience barriers to access information related to CCP positions, and may lack influence on setting minimum margin rates, allowing for netting, fulfilling criteria for membership, and participating in the development of risk models that reflect the Canadian market, it is important that Canadian regulatory authorities establish a framework for dealing with CCP's in other jurisdictions such that Canadian market participants are not at a disadvantage. Derivatives used in mutual funds subject to NI 81-102 and other similar investment products that trade customized derivatives should not be subject to additional collateral requirements as these end-users are not permitted to engage in the use of leverage. Tying up Fund capital with additional collateral requirements would therefore have a punitive effect on the Funds.

c) *Creation and Use of Canadian Single Asset or Multi-Asset CCPs used in combination with Global Single and/or Multi-Asset CCPs with collateral linkages between the CCPs*

Response:

Fidelity Canada strongly supports a CCP model that draws on the market strengths of CCP's in other markets, and allows Canadian regulatory authorities to target risks specific to the Canadian market. While this approach will require coordination and cooperation from authorities

in other markets in order to ensure Canadian market participants are treated fairly, the Canadian market should leverage its existing relationships (i.e. with memoranda of understanding) established with other jurisdictions to determine the viability of addressing systemic risk issues in Canada with information obtained from outside Canada.

3. *Is there sufficient liquidity in each of the individual Canadian derivatives markets (e.g. Equities, interest rate, commodities, foreign exchange, etc.) to support the creation of a Canadian CCP? Which derivatives markets may pose challenges to the operation of a Canadian CCP?*

Response:

Fidelity Canada does not participate directly in the derivatives markets in Canada, but has appointed advisors and sub-advisors who trade in certain OTC derivatives in the Funds. The Funds have not generally experienced liquidity issues related to the use of OTC derivatives. The use of customized forwards in the Capital Yield Funds commenced in September 2010 and to-date there have been no issues relative to the liquidity of the forwards or their underlying interests. The use of customized forwards in the Capital Yield Funds is integral to their investment mandate. However, due to the nature of these derivatives it is unlikely they would qualify for centralized clearing.

CP 91-401 defines a derivative as “an agreement where the price, value, delivery or payment obligation is derived from an underlying interest”. The scope of instruments that fit this definition is relatively broad, and for the purpose of assessing the impact of the proposals in CP 91-401, it is important that market participants understand the specific types of instruments that might be included in the proposal to mandate centralized clearing, trading etc. While this may be out of scope of the objective of CP 91-401 and the G20 commitment, providing clear guidance on which types of assets fall within the “derivative” definition would be appropriate, given the proliferation of instruments that have many of the same characteristics as a derivative, but may not be classified as derivatives (e.g. structured notes, depository receipts). Providing further guidance would enhance participants’ ability to assess whether the features of an instrument and its use are consistent with the objectives discussed in CP 91-401.

4. *Is there a willingness and an ability of Canadian market participants to use, create or participate in the creation of a Canadian CCP solution?*

Response:

As noted above, Fidelity Canada is generally supportive of efforts to establish a Canadian CCP solution, for the purpose of mitigating counterparty credit risk, provided the cost to the Funds of doing so is not prohibitive and the risk management capabilities of the Canadian CCP are adequate. We agree that the OTC derivatives market should be subject to enhanced regulatory oversight, however if a Canadian CCP cannot operate effectively due to liquidity constraints and in a manner that is cost effective for market participants, the use of CCP’s in other countries may be optimal.

5. *How should non-financial intermediary users of derivatives be able to clear their derivatives trades? Should this occur through direct access and membership in a CCP or should this be done through an indirect clearing model with financial intermediary CCP members acting as agents for the non-member CCP derivative participants?*

Response:

Fidelity Canada believes that non-financial intermediary users of derivatives should be able to clear their derivatives trades through an indirect clearing model. Although there would be costs associated with this model that would be imposed by the agent, the ability of members to deal through agents would help preserve the confidentiality of transactions and provide greater access to Canadian clearing facilities as the agent would be assuming the risk associated with the user, not the CCP.

B. TRADE REPOSITORIES

1. *Do you agree with a mandatory reporting requirement for all OTC derivatives trades? If not, should there be a threshold below which reporting would not be required?*

Response:

Fidelity Canada agrees with the principal of mandatory reporting for all OTC derivatives trades. It is important for regulatory authorities to have access to information related to OTC derivative trades and aggregate positions in order to provide meaningful oversight and to enable the identification and management of systemic risk, especially during times of economic turmoil. Fidelity Canada supports the reporting of all OTC derivative positions, as the implementation of thresholds may result in an incomplete aggregate view of systemic risk given the end-user diversity in the Canadian market.

2. *With mandatory reporting of derivatives trades, should dealers have to report non-cleared trades to a global trade repository or to a Canadian trade repository?*

Response:

Establishing a Canadian trade repository to ensure timely access to records is the preferred option, on the basis that a Canadian trade repository could better facilitate domestic regulatory oversight, manage operational risk, and impose appropriate controls on the public disclosure of OTC derivative positions. Fidelity Canada thus supports the mandatory reporting of all OTC derivative trades, and considers that dealers should have the responsibility for reporting all non-cleared trades to a Canadian trade repository. A regulatory framework already exists relative to dealer reporting activity and this should be leveraged by regulatory authorities to ensure compliance with any reporting requirements.

3. *What impediments currently stand in the way of implementing real-time reporting of data to trade repositories?*

Response:

It is important to better define the scope and intent of "real-time" reporting and whether it is being applied to trades, open interests, netted positions etc. so that market participants can assess whether the imposition of a "real-time" reporting requirement is technologically feasible or practical. Real-time reporting to trade repositories may be possible, however in the absence of a centralized trading and/or clearing facility, there may be operational process limitations on doing so. In addition, until there is some clarity relative to the data points that need to be reported, and the identification of the party responsible for reporting, it is difficult to assess whether existing trade reporting systems and control processes could support real-time

reporting. As noted above, Fidelity Canada supports the mandatory reporting of all OTC derivative trades, and considers that dealers should have the responsibility for reporting trades to a Canadian trade repository. Notwithstanding, reporting certain customized OTC derivatives that cannot be exchange-traded or cleared may be an impediment to real-time reporting as such activity may be manual in nature, and require dedicated end-user resources and administrative burden.

4. *What information, if any, should be made publicly available? Should this information be available real-time, same day or historical basis?*

Response:

Derivatives trading information should be made publicly available on a real-time basis only if the parties to the transaction remain publicly anonymous (i.e. as if traded through a dealer intermediary) to assist with intra-day price discovery and valuation. Trade activity should also generally be available on a same day and historical basis provided the counterparties to a trade remain anonymous. However, Fidelity Canada is not supportive of the real-time public disclosure of block trades as disclosing these transactions on a real-time basis may compromise a Fund's ability to effectively execute its investment strategy. If a regulatory prerogative to disclose block trades publicly were implemented, Fidelity Canada would prefer that such trades be made publicly available with a minimum 24 hour time delay. In addition, derivatives position reports for mutual funds should be disseminated in a manner that is consistent with existing mutual fund reporting requirements. Regulatory authorities should have access to relevant data at any time, but public dissemination should be done only in compliance with legislated disclosure requirements.

5. *Should a trade repository be able to publish its non-confidential data for fees?*

Response:

Fidelity Canada is generally opposed to the publication of data that may compromise the investment strategies of a Fund or the commercial interests of Fidelity Canada. In order to mitigate these concerns, it is thus necessary to further define the term "non-confidential data" so that the nature and scope of such disclosure is clear. For example, Fidelity Canada may not be opposed to the publication of aggregate position data with a time lag, but would be opposed to the real-time publication of positions on a per-trade basis. As such, it is important that the term "non-confidential data" be clarified. We agree that trade repositories should establish policies and procedures and implement controls designed to ensure the effective management of the data and consistency in the manner in which information is being disseminated. Publication for a fee or through on-going subscription may offset the operational costs associated with maintaining a registered data repository and also facilitate public and media oversight of derivative trading activities which may assist regulatory oversight efforts.

C. ELECTRONIC TRADING

1. *Should regulators choose to implement mandatory electronic trading, which of the frameworks discussed above should regulators use in respect of such implementation (i.e. mandatory trading of products subject to mandatory clearing; mandatory trading contingent on the availability of a trading platform; allowing participants to determine whether or not to trade on a platform)?*

Response:

To the extent trading in certain standardized OTC derivatives enhances price discovery, narrows spreads and increases liquidity, mandating electronic trading for standardized derivatives is a positive step. The mandatory trading of products subject to mandatory clearing is likely to enhance liquidity for both the exchange and the CCP, ensure the efficient and cost effective operation of the trading and clearing functions and enhance regulatory oversight where the CCP also acts as a data repository. Mandatory trading is, however, contingent upon the availability of a trading platform and this should be a factor considered in the analysis of derivatives that are to be subject to mandatory clearing. Ultimately, market participants should be permitted to determine whether they trade on a platform. They are in the best position to assess the costs of participation in a trading and clearing platform versus trading OTC and self-reporting to a clearing agent, data repository or regulator.

2. *Should regulators impose specific requirements on facilities where OTC derivatives trade? What specific elements should these requirements include (i.e. should these requirements be comparable to the requirements established in National Instrument 21-101 – Marketplace Operation and National Instrument 23-101 – Trading Rules?*

Response:

Regulators should consider imposing specific requirements on trading facilities in order to prevent market abuse and prevent harmful trading practices. These elements should be comparable to the requirements established in National Instrument 21-101 and National Instrument 23-101, including rules that require agreements between the facility and subscribers, that are designed to ensure best execution, that ensure the integrity of market quotations and prices, that clearly establish the characteristics of the derivative being traded, that define access requirements, that ensure transparency, and that require the implementation of compliance systems and oversight processes.

3. *Do you agree with the criteria on assessing the degree of standardization necessary for mandating trading of OTC derivatives on an organized trading platform (namely, legal, process and product standardization)? Is there any other element that the CSA should take into account?*

Response:

We agree with the criteria for assessing the standardization necessary for mandated trading. In addition to these criteria, the CSA may also consider standardizing terms relative to contract sizes and the quantity and quality of the underlying asset.

4. *Is the availability of CCP clearing an essential pre-determining factor for a derivative contract to be traded on an organized trading platform?*

Response:

While the availability of CCP clearing is not essential for a derivative to be traded on an organized trading platform, many factors considered in the assessment of derivatives eligible for trading and clearing are the same (i.e. contract standardization). Establishing a trading platform is thus a natural compliment to establishing a clearing platform with market participants

benefitting from deeper pools of liquidity, operational efficiencies, and enhanced regulatory oversight.

D. CAPITAL AND COLLATERAL

1. *What are the consequences that you foresee from higher capital requirements for financial institutions for derivatives transactions not cleared through a CCP?*

Response:

Fidelity Canada Funds that are subject to NI 81-102 and are counterparties to OTC derivative trades are not permitted to use leverage and as such maintain sufficient asset coverage of their positions on a daily mark-to-market basis. As such, there is no apparent need to make a distinction between cleared and non-cleared derivatives for the purpose of imposing additional capital requirements. To the extent financial institutions acting as counterparty to a Fund position may be engaging in the use of leverage, it is reasonable to impose higher capital requirements on those institutions that are engaged in trades not cleared through a CCP, however, the imposition of higher capital requirements would be passed on as higher costs to the Funds.

For some financial institutions, imposing higher capital requirements on derivative transactions not cleared through a CCP may cause them to seek other means of mitigating risk, likely increase their cost of risk management, or otherwise reduce or eliminate their ability to hedge risk. This may price some participants out of the market, impair market liquidity, and thus potentially increase the trading costs to the Funds and other market participants. However, higher capital requirements for non-cleared derivatives may provide a partially offsetting incentive for financial institutions to use CCP cleared derivatives which may encourage participation in the clearing process, enhance liquidity, reduce costs and facilitate systemic risk mitigation and regulatory oversight efforts.

2. *What are the consequences of mandatory collateral requirements for non-financial entities for non-cleared trades?*

Response:

As noted above, collateral requirements for non-cleared trades by non-financial entities would increase the costs of carrying a derivatives position and may result in the entity seeking other ways of mitigating risk or cause them to refrain from mitigating risk altogether. If, as a result, the liquidity for these derivatives is substantially reduced, the Funds may be exposed to increased trading costs that would have an adverse effect on returns for investors.

3. *Do the differing capital standards currently imposed by Canadian regulators result in a level playing field for OTC derivatives market participants?*

Response:

The differing standards result in a level playing field to the extent the capital markets are comprised of participants with differing business models, and capital standards are customized to the business risks associated with those models. National Instrument 31-103 applies reasonable standards for advisors, dealers and fund managers, but defers to self-regulatory organizations ("SRO"s) to identify and assess capital requirements of their members. As

important as the standards themselves is the ability of regulatory authorities to monitor and enforce compliance with capital standards and manage risk. Market participants must also be able to advocate for change where capital requirements prove overly restrictive relative to the nature of their business.

E. END-USERS AND SIGNIFICANT MARKET PARTICIPANTS

1. *What are your views on the general approach to providing commercial hedging end-users of OTC derivatives with exemptions from the mandatory clearing, electronic trading, margin and/or collateral requirements? If such trades are exempt, what would the effect be on financial institutions on the other side of these trades?*

Response:

Providing exemptive relief from mandatory clearing, electronic trading, margin and/or collateral requirements is a necessary step in ensuring the proposed OTC derivative framework does not deter end-users from trading. It is appropriate to provide exemptive relief to end-users who use derivatives for hedging purposes and where these positions do not represent undue systemic risk to the Canadian market. It is thus important to consider mutual funds within the scope of those end-users that are eligible for exemptive relief on the basis that under NI 81-102 mutual funds are not permitted to use counterparties that do not have an "approved credit rating", are prohibited from using leverage, and must comply with standards that apply with respect to the definition of a "hedge". Financial institutions on the other side of these trades that cannot rely on this relief may incur additional costs relative to mandatory regulatory requirements and make them less willing to act as a counterparty to a transaction or otherwise pass the costs of the trade onto the Fund, which would have an impact on investor returns. However, it is also important that financial institutions continue to participate in the market and these costs may be necessary in order to preserve sufficient pools of liquidity.

2. *Should there be any other exemption from the mandatory clearing or from capital margin and/or collateral requirements for any category of end-users?*

Response:

Exemptive relief should be available to mutual funds subject to NI 81-102 and other investment funds subject to similar restrictions related to the use of leverage, the requirement to use approved counterparties, and the use of OTC derivatives consistent with the regulatory definition of "hedging" purposes. Please see the previous response for more information.

F. SEGREGATION OF COLLATERAL

1. *What are your views regarding a regulatory rule requiring all collateral to be held in segregated accounts?*

Response:

A requirement to segregate collateral could make the use of OTC derivatives more costly to market participants. However, the segregation of collateral is essential to ensuring that the commitments into which counterparties have contracted can be met. The segregation of collateral would be an effective preventative measure to limit the build-up of leverage, and Fidelity Canada is strongly supportive of the segregation of collateral on an individual account-

by-account basis for both cleared and non-cleared trades. While a requirement to segregate collateral may have a negative impact on liquidity, segregation is an important component in maintaining the stability of the financial system and in times of crisis should help efforts to sustain liquidity and identify valuations, as there would be an implicit backstop of assets to support counterparty exposures.

2. *Should end-users have the ability to elect segregation of collateral/margin?*

Response:

Further to our response to Question F.1, end-users should not be permitted to elect segregation of collateral as there is little incentive to do so given the increased costs inherent in collateral segregation.

We thank you for the opportunity to comment on the proposed amendments. As always, we are more than willing to meet with you to discuss any of our comments.

Yours truly,



Fidae Abbas
Director, Compliance

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