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**Re: Canadian Securities Administrators consultation paper and request for comments:  
Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada**

**I. Introduction**

TD Asset Management Inc. ("TDAM") is pleased to submit this comment letter to the Canadian Securities Administrators ("CSA") in response to Consultation Paper 91-401 on Over-the-Counter Derivatives Regulation in Canada. We are submitting this letter in our capacity as one of Canada's largest asset managers.

TDAM is a fully integrated investment manager offering a wide range of investment products and solutions, including pooled funds, mutual funds and segregated accounts to pension plans,



endowments, foundations, trusts, corporations and individuals. In our role as agent for our clients, we may, where appropriate and applicable, incorporate the use of over-the-counter (“OTC”) derivatives as part of a larger strategy designed to meet the needs of a particular client investment mandate.

Together with our affiliates, we managed over \$183 billion of assets as of December 31, 2010. TDAM is a wholly-owned subsidiary of The Toronto-Dominion Bank.

## **II. Responses to CSA questions**

### **Section 3: 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?*

TDAM agrees with the recommendation on the approach to implement mandatory central counterparty clearing houses (“CCPs”). Specifically, we support the option of accessing Global Single and/or Multi-Asset CCPs.

The degree of contract standardization that currently exists for the OTC derivatives and trading liquidity should be the key drivers for determining which OTC derivatives are capable of being cleared. We have some concern in the event that additional mandatory contract standardization is introduced in order to centrally clear an OTC derivative, as this may limit the end users’ abilities to customize investment strategies to address their particular goals.

*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; b) Accessing Global Single and/or Multi-Asset CCPs, with additional collateral requirements for non-cleared trades not available for clearing globally; or c) Creation and Use of Canadian Single Asset or Multi-Asset CCPs used in combination with Global Single and Multi-Asset CCPs with collateral linkages between the CCPs.*

Ideally, a Global CCP should be established for each product/market and be maintained in the jurisdiction where the product/market is domiciled. Where multiple products/markets are in the same jurisdiction, one Multi-Asset CCP would be desirable and should allow for the netting of collateral. The allowable collateral should be broad-based enough so that the capital/margin

requirements are not taxing on the end users. For example, allowing a broad subset of securities, such as bonds, stocks and other money-market instruments, will alleviate the need to hold idle cash in the operation/fund to support margin requirements (initial and variation).

Of the models suggested by the CSA Derivatives Committee (“Committee”), our preference is option b, Accessing Global Single and/or Multi-Asset CCPs, with Additional Collateral Requirements for Non-Cleared Trades not Available for Clearing Globally.

*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?*

Yes. A multi-asset Canadian CCP would be warranted to clear the various Canadian derivative instruments.

Customized derivatives, including custom total return swaps, would potentially be difficult to contractually standardize for central clearing.

*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?*

TDAM is willing to use a Canadian CCP solution for Canadian denominated or Canadian specific OTC derivative instruments that are suitable for central clearing provided it is efficient and can effectively create linkages to other CCPs globally.

*5. How should non-financial intermediary users of derivatives be able to clear their derivative 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?*

We believe that non-financial intermediary users of derivatives should clear their derivative trades through an indirect clearing model. CCP membership should be limited to large financial intermediaries acting as agents for non-member CCP derivative participants. Using this “clearing broker” approach avoids needless complexity and maximizes efficiency.

Where an asset manager is acting as an agent on behalf of a client, the rights and obligations concerning the OTC derivative are between the CCP and the end user. Given that the ultimate counterparty risk resides between the ultimate end user and the CCP, any forthcoming

regulations should reflect the agency arrangements currently in place in the Canadian OTC derivatives market.

## COMMENTS

We support maximum efficiency in central clearing. Ideally, we envision one Global clearer per product covering all jurisdictions. If a global solution is not possible, clear communication and information sharing between CCPs will be imperative for this to work efficiently. Multi-asset class netting is desirable, but is likely more complicated to implement. As well, multi-asset class CCPs and broad based coverage for margining are also desirable.

While we support the general trend of moving towards CCP use, we have some concerns about how this will be implemented. For example, on the issue of risk mutualisation in the event of a default within the CCP model, we question whether this is better or worse than what currently exists in a bilateral arrangement. The answer is highly dependent on the quality of other counterparties clearing through the CCP.

There are implementation issues directly related to an asset manager's role as agent for its clients. For example, in a CCP model, will end users working with an asset manager intermediary need to set up an account with the member of the CCP directly to clear their trades?

Other concerns include the fact that corporate end users have limited capital to pledge in a clearing model. Furthermore, matching hedge dates could be problematic with standardization of instruments in the exchange-traded model. Ideally, some flexibility should continue to exist in the characteristics of the derivative and the eligible collateral in the CCP model.

### Section 4. 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?*

We support a mandatory reporting requirement for all OTC derivative trades. Similar to listed futures, the CSA may want to obtain additional reporting from end users who have relatively larger positions beyond a set threshold.

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

We believe that all trades, including non cleared trades should be reported to a trade repository. This may go a long way in resolving the CSA's concerns and potentially reduce the need for electronic trading, clearing, and margin, as bilateral agreements are sufficient to deal with this. Additionally, we believe that the CSA's ability to access the information that it needs will drive the preference for a global vs. a Canadian trade repository.

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

Given that exchange traded futures and options have been centrally cleared for many years in the absence of any apparent material issues, we suggest an analysis of this model be completed in order to potentially avoid any impediments that may stand in the way of implementing real-time reporting of data to trade repositories.

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

Given the unique nature of some OTC trades, it is inadvisable to share this information with the public as it may result in sensitive trade information leakage. However, if it is determined that some public dissemination of information is necessary to increase transparency, then the concerns of large traders should be taken into account, and the least harmful method (e.g. historical, aggregate data) be used when publishing the information.

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

Our preference is that no data should be published, even for a fee. Again, if it is determined that some dissemination of information is desirable, please consider the points above.

## **COMMENTS**

TDAM supports the creation and use of trade repositories as the most effective way to address the problem of systemic risk. Trade repositories will provide the CSA with the detailed level of information required to monitor risk levels.

On the other hand, the public sharing of information is problematic. How openly will data be shared at the trade repositories? Large and sensitive trades could be traced back to end users and this may result in information leakage that is not desirable by the originating end users.

Reporting to a trade repository appears to address many of the G20 and regulatory concerns related to the lack of transparency and the degree of systemic risk in the system due to OTC

derivative positions. Given this fact, even if there are many end users who are ultimately exempted from clearing and collateral requirements, the repository reporting requirement on its own, applied across the board, should be sufficient to address the primary concerns of regulators.

## **Section 5. 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)?*

Our preference is mandatory electronic trading contingent on the availability of a trading platform and subject to retaining some degree of flexibility to customize the characteristics of the derivative transaction.

*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)?*

We would support the establishment of prescribed requirements on the facilities where OTC derivatives trade. The requirements could be comparable to those of the above mentioned instruments, but should be relevant to the OTC derivative being traded.

*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?*

Given the level of standardization that currently exists within the exchange traded futures and options markets, the CSA should consider providing additional flexibility in the terms for other OTC derivatives that will be considered for electronic trading. For example, the size of the contract and term maturity should be variable as opposed to fixed.

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

Yes. Standardization within a specific OTC derivatives market is also essential for electronic trading. Flexibility in some of the characteristics of the derivatives transactions executed electronically is desirable.

## **Section 6. Capital and Collateral**

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

Higher capital requirements will likely result in higher costs being passed on to the end users. There could also be potentially fewer liquidity providers for some markets.

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

Mandatory collateral requirements in these cases would likely result in a less efficient use of capital. We would ask that the CSA encourage the CCPs to broaden the potential acceptable forms of collateral prescribed in any regulations.

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

Capital standards for a particular party accessing the derivatives market should reflect all relevant factors.

## **COMMENTS**

As an asset manager, it is important for us to have the flexibility required to make the most appropriate and cost effective decision for our clients. Therefore, with respect to collateral requirements, it is important to determine what the required type and amount of collateral will be for each OTC derivative. In our view, it is important that a high degree of flexibility be maintained with regards to the types of securities eligible for collateral and margin.

## **Section 7. End-Users and Significant Market Participants**

*1. What are your views on the general approach of 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?*

We believe that commercial hedging end users should be exempt from mandatory clearing, electronic trading, margin and/or collateral requirements. The effect on financial institutions using the CCP on the other side of these trades would be a potential exposure to the CCP having unmatched trades.

*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?*

Asset managers that do not act on behalf of their own account and act as agents on behalf of certain end users, including mutual funds, pooled funds, pension plans, foundations, endowments, and other individual and institutional clients should be eligible for an exemption from the capital margin and/or collateral requirements.

In our view, the degree of use of leverage, and the creditworthiness of the end user should be factors that prevent a user from being able to take on additional risks through the purchase of further OTC derivatives, since these factors greatly affect the risk level inherent in an OTC derivative trade. In contrast, mutual funds are already highly regulated, and restricted in their use of leverage. This places limits on how much risk they are exposed to through their derivative use since their use of derivatives is highly circumscribed.

Pension plans also fall into a distinct category that should qualify for an exemption. Like businesses that use derivatives to hedge particular business risks rather than for speculation, pension plans operate under similar constraints in that they must hedge against their liabilities. A pension plan's liabilities or obligations to its pension members is a business risk that is unique. Charitable foundations should also be considered to fall into a similar category.

## **COMMENTS**

How will "participant" be defined for the purposes of determining who would qualify for the end user exemption?

### **Section 9. Segregation of Collateral**

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

We support segregation of collateral to mitigate the mutualisation of risk in the event of a default by another client within the CCP.

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



End users should have the ability to elect for segregation of collateral/margin.

### **III. Conclusion**

Thank you for this opportunity to comment on your consultation paper. TDAM is strongly in support of greater transparency and accountability in the use of OTC derivatives, and we support the global movement towards increased regulation. At the same time, as an agent for clients who may depend on derivatives as a way of meeting their investment mandate requirements, we wish to stress the importance of implementing these regulations in a measured, proportional, prudent and restrained manner, so as not to have a severe and detrimental effect on the market.

We would be happy to make ourselves available for further discussion or clarification concerning our response and comments.



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