Submission on Proposed National Instrument 25-102 Designated Benchmarks and Benchmark Administrators

06/12/2019

Submission to the Canadian Securities Administrators

ASSOCIATION DES BANQUIERS CANADIENS
CANADIAN BANKERS ASSOCIATION

Delivered via email

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8
comment@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square Victoria, 4e étage
C.P. 246, Place Victoria
Montréal (Québec) H4Z 1G3
consultation-en-cours@lautorite.qc.ca

The Canadian Bankers Association (CBA)[1] appreciates the opportunity to comment on the Canadian Securities Administrators' (CSA) Proposed National Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* and Companion Policy (together, the Proposal). We support the policy intent behind the Proposal, namely, to reduce risk in Canada's capital markets, thereby protecting Canadian investors and other Canadian market participants. We have set out below our comments on various aspects of the Proposal.

Limiting the Scope of Designated Benchmarks

We support the CSA's approach of designating only the Canadian Dollar Offered Rate (CDOR) and the Canadian Overnight Repo Rate Average (CORRA) as benchmarks. Further, we support the approach of specifically naming the benchmarks and administrators (Refinitiv Benchmark Services (UK) Limited for both CDOR and CORRA) subject to the Proposal. This targeted approach is much more definitive and gives the market greater certainty than the "catch and release" approach under the European Union's *Regulation on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds* (EU BMR), which assumes all potential benchmarks and administrators are in scope unless otherwise explicitly stated.

We encourage the CSA to limit designated benchmarks to those that represent a significant component of the Canadian financial markets and for which the administrator is, or the majority of contributors to such benchmarks are, Canadian. With these two principles in mind, the Proposal should only apply to CDOR

[1] The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. www.cba.ca.

and CORRA. In Principles for Financial Benchmarks, the International Organization of Securities Commissions (IOSCO) notes that implementation of the principles "should be proportional to the size and risks posed by each Benchmark and/or Administrator and the Benchmark-setting process."[2] Given the significant compliance requirements outlined in the Proposal, in our view, it would not be proportional to bring benchmarks into the scope of these rules unless they represent a material component of the Canadian financial markets (as is the case with CDOR and CORRA).

We have concerns with the CSA regulating foreign benchmarks in light of the experience implementing the EU BMR. Non-EU benchmark administrators have been, and may continue to be, hesitant to spend the time, money and effort to comply with the EU BMR. There was a significant risk that EU firms and investors were going to be cut off from access to financial products that reference non-EU benchmarks after January 1, 2020. This resulted in the European regulators agreeing to delay compliance with the EU BMR by third country administrators of benchmarks for two years.[3] Foreign benchmark administrators would be even less likely to expend the effort to comply with the Canadian benchmark rules given the relatively small size of the Canadian market.

Application of Proposal to Committed Rates

CDOR differs greatly from other interbank offered rates (IBORs) in that it is a committed rate (i.e., the rate at which a contributing bank is obligated to lend funds to corporate borrowers with existing committed credit facilities that reference CDOR, plus a stamping fee (if applicable)). CDOR is based on committed quotes provided by rate submitters, whereas most IBORs are based on indicated quotes (i.e., the quotes are not binding on the submitters). As noted in the Financial Stability Board (FSB) Report on Reforming Major Interest Rate Benchmarks, committed quotes are higher in the underlying data waterfall for benchmark rates and are the FSB's preference when actual transaction data is unavailable to underpin a rate.[4] In our view, the compliance requirements in the Proposal should consider this important feature of CDOR and committed rates should be subject to a less stringent application of the proposed rules.

Physical Separation and Secure Areas

In a few instances, the Proposal requires the physical separation of individuals responsible for the

[2] Principles for Financial Benchmarks Final Report, The Board of IOSCO, July 2013, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf, page 4
[3] https://www.risk.net/derivatives/6433251/banks-call-for-third-country-benchmark-fix-as-ec-delays-bmr
[4] Reforming Major Interest Rate Benchmarks, FSB, July 22, 2014, https://www.fsb.org/wp-content/uploads/r_140722.pdf, page 12

contribution of input data from others in the organization and the location of such contributing individuals in a "secure area". For example, section 25(2)(d)(i) requires a benchmark contributor to have policies, procedures and controls governing organizational separation of contributing individuals from employees whose responsibilities include transacting the underlying interest of the benchmark. Section 40(3)(f) requires a benchmark contributor to have policies, procedures and controls reasonably designed to ensure that there is a requirement that contributing individuals work in locations physically separated from interest rate derivatives traders. Further, the commentary in the Companion Policy on section 25(1)(a) provides that if the benchmark contributor identifies a conflict of interest involving other business activity, the contributor should ensure that contributing individuals are located in a secure area apart from persons that carry out the other business activity.

It is unclear what the terms "organizational separation", "physically separated" and "secure area" mean. Does "organizational separation" refer to physical separation, separation within the contributor's corporate organizational structure, or both? Alternatively, is the requirement simply that contributing individuals not be co-located with other employees? Or do these terms require a physically segregated area with restricted access as contemplated by section 2.3 of Ontario Securities Commission Policy 33-601 *Guidelines for Policies and Procedures Concerning Inside Information*? We note that some contributing individuals are dual-hatted and have other responsibilities including selling money market instruments, such as treasury bills. Such employees, therefore, require access to sales and trading staff and proximity to such staff is important to be efficient and respond to clients' needs in a fast-paced trading environment.

We understand that the CSA's intention may be to provide contributors with flexibility in how to implement the separation for avoidance of conflict, and not to prescribe what type of separation and what degree is necessary (i.e., whether individuals need to be in different buildings, on different floors, or in different sections of the same floor, etc.). This would be consistent with the new CDOR Code of Conduct which requires benchmark contributors to maintain controls for the identification and avoidance of conflicts of interest including potentially the organizational separation of contributing individuals from employees. We support giving contributors flexibility in interpreting the CSA provisions and recommend that the Proposal include more definitive language authorizing such flexibility.

Expert Judgment

Section 25(3)(b) of the Proposal provides that before contributing input data for a designated benchmark, a benchmark contributor must, if expert judgment is exercised in relation to input data, retain records that record the rationale for any decision made to use that expert judgment and the manner of the exercise of

the expert judgment. For benchmark contributors, “expert judgement” is defined under section 1.(1)(b) as “the discretion exercised by a benchmark contributor with respect to the contribution of input data”.

We seek clarification regarding the types of records required by this section. While CDOR is a committed bank lending rate or executable rate, a degree of expert judgment is always applied. We would appreciate further detail as to whether the requirement is to address the circumstances in which expert judgment may be exercised in policies and procedures or whether the expectation is to record the rationale for the use of expert judgment in each and every daily submission. If the latter is required, this will place a significant burden, both in terms of gathering and tracking of expert input provided in relation to the contribution of input data and properly describing the discretion exercised by the bank expert as their judgement will be relied upon for a diverse set of submissions.

In addition to the above, we believe that the documentation of the use of expert judgement under Section 25(3) should be tailored to CDOR and CORRA and mirror the Submission Procedures under the new CDOR Code of Conduct.

Recordkeeping Requirements

Section 25(4) of the Proposal requires a benchmark contributor to keep certain records for a period of 7 years. This is longer than the requirement under the EU BMR (i.e., 5 years with the exception of records of telephone conversations or electronic communications, which are required to be held for 3 years). We propose that the time period for holding records of the items set out in section 25(4) be reduced to align with the EU BMR. Further, due to their sensitive nature, we believe that the records listed in section 25(4) should only be required to be made available to the administrator if the administrator requires them to comply with the Proposal or in connection with investigations by Canadian regulatory authorities. That is, there must be reasonable grounds for the administrator to have access to the records.

Section 25(4)(d) requires benchmark contributors to hold records relating to “a description of the potential for financial loss or gain of the benchmark contributor and each contributing individual to financial instruments that reference the designated benchmark for which it acts as a benchmark contributor.” It is unclear how to satisfy the compliance obligations set out in this section. There are a number of variables to consider in calculating profit and loss as well as system and process needs. We would appreciate regulatory guidance in the Companion Policy. Related to this, section 25(5) requires benchmark contributors to make available such records to the benchmark administrator and any public accountant in connection with any assurance report under the Proposal. We are concerned that “descriptions of the

potential for financial loss or gain" could contain proprietary commercially sensitive information that contributors would not wish to share with third parties because of commercial sensitivities. As such, we suggest that section 25(4)(d) be either struck out or narrowed to apply only to the contributing individual. Alternatively, we recommend that this requirement be met in the context of identifying and mitigating conflicts of interest by amending section 25(4)(c) relating to the documentation of conflicts of interest as follows: "(c) all documentation relating to the identification and avoidance of conflicts of interest or mitigation of risk resulting from conflicts of interest, including the contributor's and each contributing individual's exposure to financial instruments that reference the designated benchmark for which it acts as contributor." The foregoing would align more closely with EU BMR requirements.

Input Data Sign-off

Section 25(2)(b) provides that a benchmark contributor must have a process for sign-off on input data by an individual holding a position senior to that of the contributing individual. We believe that this requirement is unwarranted because the individual contributor has the expertise to make the submission. Further, this requirement is impractical from a timing perspective, as it would unnecessarily slow down the submission process. The new CDOR code of conduct provides for an annual attestation by senior management, which we believe is sufficient to tie senior management to the approval of the submissions process.

Input Data Code of Conduct

Under section 24.(2)(f)(iv), a benchmark contributor would be required to establish and maintain systems and controls relating to the validation of input data before it is contributed to the benchmark administrator. Requiring pre-submission sign-off would impede the process for collecting and disseminating input data.

Compliance Officer

Section 26(2) provides that the compliance officer who monitors and assesses compliance by the contributor and its employees with the code of conduct must be able to directly access the contributor's board of directors. In our view, the requirement for direct access is impractical. Further, the compliance officer would lack the experience and expertise to make board submissions. We believe it would be more reasonable to require the compliance officer to escalate matters up through senior management. If an issue were to arise, the contributor's chief compliance officer could then present the matter directly to the board.

Under section 40.(6), a benchmark contributor's compliance officer would be required to report any compliance findings on a regular basis. We believe that the requirement should be to report significant issues, rather than findings, as this would otherwise be overly burdensome for an organization's compliance officer.

Assurance Report on Benchmark Contributor

Section 39 requires benchmark contributors to engage a public accountant to provide an assurance report within 6 months of the introduction of a code of conduct for contributors and every 2 years thereafter. This is a net new requirement that will be unduly onerous for contributors, when external audits are not required by the already comprehensive assurance provisions of either the CDOR contributors' code of conduct or the EU BMR in relation to CDOR. We believe that the requirements in sections 34 and 38 to provide an assurance report if requested to do so by the oversight committee are more reasonable and sufficient. Should there be an audit requirement, it would be more appropriate for the contributor to conduct the audit internally, as the internal audit function is better positioned to assess a contributor's compliance (this is consistent with the annual audit requirement under the CDOR code of conduct). Additionally, if an audit requirement is included, the results should only be made available to the regulators, not to the administrator.

Benchmark Administrator is a Public Authority

Section 4 of Part 1 of Annex D to the Proposal indicates that the "CSA has no current intention of designating benchmarks (or their administrators) that are administered by governments (including government statistical agencies), central banks, crown corporations and similar public authorities." We request that the CSA clarify in the Proposal that in the event a designated benchmark becomes administered by one of the foregoing public authorities, the requirements of the Proposal will no longer apply to such a benchmark. As noted in Annex D, these entities are already exempted from the EU BMR and "[i]n particular, central banks already meet principles, standards and procedures that ensure that they exercise their activities with integrity and in an independent and robust manner. It is therefore not necessary that such entities be subject to Proposed NI 25-102."

Written Plans Required if a Designated Benchmark Ceases

Section 22(1) requires certain users of designated benchmarks to establish and maintain a written plan of action to address a significant change to, or cessation of, a designated benchmark. Section 22(3) further provides that if a reasonable person would consider it appropriate, certain users must reflect that plan in

any security issued by that user, or derivative to which that user is a party, that references the designated benchmark. We request that the Proposal clarify that the foregoing requirements apply only to securities and derivatives that are entered into on or after the effective date of the Proposal. Users will generally not have the legal right to compel existing security-holders and derivative counterparties to agree to changes to the terms of such financial instruments.

Mandatory Contribution to a Designated Benchmark

As mentioned in Part 6 of the Companion Policy, securities legislation provides that a securities regulatory authority may require a person or company to provide information to a designated benchmark administrator in relation to a designated benchmark if it is in the public interest to do so. This may include providing information for the purpose of determining a designated critical benchmark. However, unlike Article 23 of the EU BMR, there is no limit on the period of time for which a person or company is mandated to provide such information nor specific criteria that must be met in order to continue or withdraw the mandatory provision of information. Article 23 of the EU BMR also specifies that contributors are not obligated to trade or commit to a trade.

It would be a significant hardship for persons and companies to be mandated to contribute to a designated benchmark and therefore required to comply with the Proposal as a contributor for an indeterminate period of time. This would entail considerable costs and resources and could expose these contributors to increased risk. We therefore request that the Proposal adopt similar requirements to those set out in Article 23 of the EU BMR. That is, the Proposal should: (i) set out the specific circumstances under which a person or company is required to provide information to a designated benchmark administrator; (ii) limit the mandatory provision of information by a person or company to a designated benchmark to a maximum of 24 months; (iii) require on a periodic basis (e.g., within one month and if, necessary, 12 months after contributors are required to provide information) an assessment against specified criteria to determine if continued mandatory contribution is necessary for another specific period of time; and (iv) confirm that contributors are not obligated to trade or commit to trades relating to the designated benchmark.

****

Thank you for considering our comments on the Proposal. We look forward to further engagement on this issue.