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John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
e-mail: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Secrétaire de l'Autorité
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec
H4Z 1G3
e-mail: consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators ("CSA") Staff Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives

INTRODUCTION

We appreciate the opportunity to provide comments on the Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives set out in CSA Staff Notice 91-303 (the "**Proposed Rule**").[1] The intent of the Proposed Rule is to impose a central clearing requirement to improve transparency in the derivatives market and to enhance the overall mitigation of risks. Through its exemptions, the Proposed Rule recognizes that derivative transactions entered into by an end-user or its affiliates for purposes of hedging or mitigating commercial risk are considered low risk and therefore exempt from the clearing requirement. The changes proposed in this submission are consistent with the effect of changes that have been approved in other jurisdictions. However, because of the "as agent" language in one of the exemptions, the clearing requirement under the Proposed Rule may apply to unintended entities, such as centralized treasury units. The suggested changes address, in Ford's opinion, these unintended technical consequences. For these reasons, we are submitting this comment letter to request clarity on the affiliate end-user exemption under subsection 7(2) of the Proposed Rule.

BACKGROUND

Ford Motor Company ("**Ford**") is a global automotive industry leader based in Dearborn, Michigan, operating in Canada through Ford Motor Company of Canada, Limited ("**Ford of Canada**"). With about 181,000 employees and 65 plants worldwide, Ford manufactures or

[1] Canadian Securities Administrators, CSA Staff Notice 91-303 Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives (2013) 36 OSCB 12025. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20131219_91-303_mandatory-counterparty-clearing-derivatives.pdf.

distributes cars and trucks across six continents. In addition, Ford, through its wholly-owned subsidiary, Ford Motor Credit Company LLC ("**Ford Credit**"), provides financing that supports the sale and lease of cars and trucks produced by Ford. Ford Credit operates globally, including in Canada through its wholly-owned subsidiary, Ford Credit Canada Limited ("**FCCL**").

In the normal course of business, Ford's operations are exposed to global market risks, including the effect of changes in foreign currency exchange rates, certain commodity prices and interest rates. To manage these risks, Ford enters into OTC derivative transactions through its centralized treasury unit, Ford Global Treasury, Inc. ("**FGT**"). FGT hedges risk for the consolidated Ford group, serving as the primary external market-facing entity. FGT enters into OTC derivatives with Ford affiliates, including Ford of Canada and FCCL, and then executes external trades with third parties based on the net risk to Ford. This structure centralizes risk management, consolidates swaps expertise and talent, increases administrative efficiency and facilitates netting of counterparties thereby reducing market-facing transactions. Thus, conducting hedging activities through the use of a centralized treasury unit lowers the overall credit risk that Ford poses to the market generally. In addition, this structure allows FGT to secure better pricing for its derivatives transactions, allowing Ford to pass along savings to its customers or use these savings to grow its businesses and create jobs.

DISCUSSION

Subsection 7(2) of the Proposed Rule (the "**Affiliate End-User Exemption**") provides that the mandatory clearing requirement under section 4 of the Proposed Rule does not apply to a transaction entered into by an affiliated entity of a company that qualifies for the exemption under subsection 7(1) (the "**End-User Exemption**"), if certain conditions apply, including a condition that the affiliated entity is acting as agent on behalf of the person or company. Thus, the Affiliate End-User Exemption provides an exemption from clearing for a derivatives hedging transaction entered into by a centralized treasury unit, such as FGT, on behalf of an affiliate that qualifies for the End-User Exemption, but only if FGT is "acting as agent on behalf of the person or company" (emphasis added).

As is the case with the vast majority of centralized treasury units, FGT enters into market-facing transactions on a principal basis even though it is doing so for the benefit of the applicable affiliate and as part of the affiliate's hedging strategy. The explanatory guidance for the Proposed Rule states in section 3 that as long as there is a reasonable commercial basis to conclude that transactions are intended to be a part of the end-user's hedging strategy, the hedge should qualify for the exemption. Accordingly, for purposes of the exemption, Ford submits that it is irrelevant whether FGT is entering into the transactions as principal or as agent. However, if FGT were to enter into market-facing transactions as agent for the particular affiliate (and not as principal), it would not be able to maximize netting opportunities and secure better pricing for its OTC derivatives transactions thereby reducing the benefit of a centralized structure.

As FGT enters into OTC derivatives transactions for the benefit of its affiliates, Ford believes that the use of the word "agent" in paragraph 7(2)(a) of the Proposed Rule would not restrict FGT from claiming the Affiliate End-User Exemption even if it enters into the market-facing transaction on a principal basis. However, there is concern that the use of the word "agent" could be interpreted using its strict legal meaning (i.e. that the parties are in a principal/agent relationship) so as to make the Affiliate End-User Exemption unavailable when entering into transactions on a principal basis. This suggestion creates considerable uncertainty for end-users, such as Ford, that use centralized treasury units. For these reasons, Ford submits that

paragraph 7(2)(a) of the Proposed Rule should be deleted. The introductory language of paragraph 7(2) already provides that the transaction needs to be entered into by an affiliated entity of the end-user, and paragraph 7(2)(b) already provides that the transaction needs to be a hedge that mitigates the commercial risk of the end-user or another affiliate of the end-user. Accordingly, paragraph 7(2)(a) seems unnecessary. Alternatively, if paragraph 7(2)(a) is retained, Ford submits that it should be clarified in the final mandatory clearing rules that market-facing transactions entered into on a principal basis by a centralized treasury unit would qualify for the Affiliate End-User Exemption (provided the conditions under paragraphs 7(2)(b) and (c) of the Proposed Rule are also satisfied).

In the US, the CFTC issued no-action relief from the clearing requirements for centralized treasury units meeting certain qualifications, one of which was the provision of a parent guaranty of the centralized treasury unit's trades.[2] If paragraph 7(2)(a) is not deleted nor clarified, Ford submits that it could have a detrimental effect on "sell-side" Canadian market participants. If faced with uncertainty under Canadian mandatory clearing rules as to whether its market-facing transactions with Canadian banks qualify for the Affiliate End-User Exemption, FGT would be incentivized to transact with non-Canadian counterparties that qualify for a clearing exemption under the US rules. This would be the case even if the reason for entering into market-facing transactions by FGT is to hedge Ford of Canada or FCCL market risks.

If the requested clarification is not made, or if the CSA takes the position that market-facing swaps entered into by centralized treasury units on a principal basis do not qualify for the Affiliate End-User Exemption, end-users that use a centralized treasury unit to manage risks will be disadvantaged relative to their direct competitors that do not have the same structure. This outcome would not promote fair competition given that an end-user with a centralized treasury unit established as a separate legal entity would have to either restructure, clear its market-facing swaps (both of which diverts cash, resources and time) or have fewer counterparty choices while its direct competitors without such a structure would not face these obstacles.

CONCLUSION

Ford supports financial regulatory reform of the OTC derivatives market and in particular, recognizes the importance of central counterparty clearing. However, this reform should not impose undue burden on end-users. End-users did not contribute to the financial crisis and unnecessarily regulating them would create more economic instability, restrict job growth and decrease productive investment. Moreover, adopting a position under Canadian mandatory clearing rules that is different, and more onerous for the end-user, than the rules in the US will place Canadian market participants at a significant disadvantage over their US and global counterparts.

For the reasons stated above, Ford submits that the condition under paragraph 7(2)(a) of the Proposed Rule should be deleted or, in the alternative, amended to read "the affiliated entity is acting on behalf of the person, company, or on behalf of an economic group of persons or companies".

In addition, Ford submits that the explanatory guidance should expressly provide that market-facing swaps entered into by centralized treasury units on a principal basis qualify for the

[2] CFTC No-Action Letter No. 13-22 (June 4, 2013), available at *http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-22.pdf*

Affiliate End-User Exemption under subsection 7(2) of the Proposed Rule (provided that the conditions under paragraphs 7(2)(b) and (c) are also satisfied).

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Thank you for your attention. Should you wish to discuss this issue in more detail please do not hesitate to contact Matt Armbruster at (313) 322-5610 or the undersigned.

Sincerely,

Neil M. Schloss
Treasurer
Ford Motor Company

Al McCormick
Vice President and Director
Ford Motor Company of Canada, Limited

Paul H. Monjanel
President
Ford Credit Canada Limited