

March 7, 2012

Alberta Securities Commission  
Autorité des marchés financiers  
British Columbia Securities Commission  
Manitoba Securities Commission  
New Brunswick Securities Commission  
Nova Scotia Securities Commission  
Ontario Securities Commission  
Saskatchewan Financial Services Commission

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**Re: CSA Consultation Paper 91-404  
Derivatives: Segregation and Portability in OTC Derivative Clearing**

The Canadian Advocacy Council<sup>1</sup> for Canadian CFA Institute<sup>2</sup> Societies (the CAC) appreciates the opportunity to comment on the Canadian Securities Administrator's request for feedback on

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<sup>1</sup> The CAC represents the 12,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at <http://www.cfaadvocacy.ca/> Our Code of Ethics and Standards of Professional Conduct can be found at <http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx> .

<sup>2</sup> CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 110,000 members, who include the world's 90,000 CFA charterholders, in 135 countries and territories, as well as 135 affiliated professional societies in 58 countries and territories. More information may be found at [www.cfainstitute.org](http://www.cfainstitute.org).

the Consultation Paper 91 – 404 on Derivatives: Segregation and Portability in OTC Derivatives Clearing.

In general the CAC supports the development of Canadian rules that provide strong competitiveness in the domestic market, are regulated to achieve a level playing field for all participants and to ensure adequate rules and infrastructures are in place to provide adequate protections to all market participants involved in the OTC derivatives market. By achieving these goals, this will ensure that the integrity of the derivatives market will provide confidence for all market international and domestic participants.

**Question 1: Are there any differences between the Principal and Agency Models the Committee should be aware of in forming the policies and rules for segregation and portability?**

The difference between the two models is that the Principal model has additional risks and at first instance, there may be a concern about the counter party risk. With more risk a higher standards are required through transparency and due diligence.

**Question 2: Should variation margin be required to be provided to a CCP on a gross basis?**

We agree that variation margin should also be required to be provided to a CCP on a gross basis because risks can and may be asymmetrical and having sufficient margin on a gross basis will reduce the impact of a single bankruptcy. Margin on a net basis has the potential to create liquidity issues. On a gross basis, it will provide for more transparencies and the issue of portability and execution would be more credible because no two counterparties have the same risk books or the same financial metrics; hence asymmetry may occur with one side of the transaction having a strong financial position vs. the other counterparty.

**Question 3: Do you agree with the Committee's recommendation that CCPs adopt the Complete Legal Segregation Model?**

We believe that the adoption of the Complete Legal Segregation Model is the best tradeoff in terms of cost and benefit and it would be up to the regulators to monitor and ensure compliance. The other models are cost prohibitive and would not provide the same return of protection for the money spent.

**Question 4: Are there any benefits to the Full Physical Segregation Model that would make it preferable to the Complete Legal Segregation Model?**

We do not feel that at the margin there are additional benefits to the Full Physical Segregation Model that would make it an acceptable solution. Also the cost incurred would most likely be passed on to the ultimate customer.

**Question 5: Should there be specific permitted investment criteria for customer collateral?**

Yes, we feel that standardization and transparency of the permitted investment criteria will make the market more robust and have consistent collateral valuation. Additional valuation issues

should not cloud the issue in the event of a default. Furthermore, the issue of the quality of the liquidity would also be of concern and the use of credit agency ratings only serve as a guideline.

**Question 6: If yes, what types of investments are suitable for customer collateral held in connection with indirectly cleared OTC derivatives transactions?**

The types of investment that would be suitable for customer collateral held would include federal and provincial government securities, letter of credit of Schedule A Canadian banks or cash.

**Question 7: Is re-hypothecation of customer collateral consistent with the goals of the Complete Legal Segregation model and should it be permitted?**

No, we disagree that there should be re-hypothecation of customer collateral as this would undermine the integrity of the market system and create additional loop holes. In the case of a default or bankruptcy, the collateral would be compromised and the issue would be unduly complicated.

**Question 8: Should clearing members be required to offer collateral holding arrangements with a third-party custodian for customer collateral held in connection with an indirectly cleared OTC derivatives transaction?**

Yes, we agree that there should be a requirement to offer collateral holding arrangements with a third party custodian to ensure that there is more transparency and independence.

**Question 9: What would be the costs and benefits of a requirement that all Canadian customer collateral be governed by Canadian laws?**

We are not in the position to quantify the costs and benefits but the laws should be harmonized as much as possible to international laws to ensure there is a fair playing field for Canadian market participants and to ensure it will promote transparencies and adds to the credibility of the Canadian market which ultimately benefits the investors.

**Question 10: Are there any risks that portability arrangements may have on clearing members who accept customer positions in the event of a clearing member default?**

We refer to question 8.

**Question 11: Do you agree with the Committee's recommendation that OTC derivatives CCPs should be required to facilitate portability for customers at their discretion?**

Given the dynamic positions of derivative trades, we agree that the flexibility is helpful and if there is portability then the transparency and trust will build when the system is able to work under stressed scenarios.

**Question 12: Should OTC derivatives dealers be required to offer arrangements for collateral to be held with a third-party custodian for uncleared transactions?**

Yes, we agree that OTC derivatives dealers be required to offer collateral arrangements to be held with third-party custodians for uncleared transactions as this will provide the same transparencies

and build flexibility in the system. Uncleared transactions should meet similar conditions as cleared transactions.

### **Concluding Remarks**

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at [chair@cfaadvocacy.ca](mailto:chair@cfaadvocacy.ca) on this or any other issue in future.

(Signed) Keith Summers

**Keith Summers, CFA**  
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