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## By email

Monday, September 26, 2011

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Manitoba Securities Commission  
New Brunswick Securities Commission  
Ontario Securities Commission  
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### **Re: CSA Consultation Paper 91-402 Derivatives: Trade Repositories**

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Dear Sirs and Mesdames:

The Canadian Depository for Securities Limited (CDS) is pleased to provide comments in regards to trade repositories for derivatives. CDS has been an active participant in the ongoing dialogue concerning Canada's plans to meet the G-20's reforms for the processing of over-the-counter (OTC) derivatives. CDS is committed to advancing thoughts and proposing solutions in this regard.

In our submission, CDS comments on the role played by a trade repository within the larger context of the overall OTC derivatives infrastructure, the functionality contained within a trade repository and the possible ways in which a trade repository could be introduced into the Canadian OTC derivatives environment.

### ***CDS - a world leading financial market intermediary***

CDS has an established record of accomplishment in the design and development of cost-effective, consensus-driven solutions for the Canadian capital markets. As one of the world's leading financial market infrastructures (FMI), CDS believes it can play a central role in the reporting and processing of OTC derivative transactions, leveraging its position as Canada's national securities depository, and its role as a clearing and settlement hub for cash market trades in both equity and debt securities.

CDS is a private business corporation, incorporated federally on June 9, 1970 under the *Canada Corporations Act* and continued in 1980 under Section 181 of the successor *Canada Business Corporations Act*. CDS is owned by the six major Canadian chartered banks, the Investment Industry Regulatory Organization of Canada (IIROC) and the TSX Inc. Approximately 100 direct participants use the services of CDS.

CDS has approximately \$4 trillion of securities on deposit and processes over 350 million exchange-traded and OTC transactions annually. CDS, through its wholly-owned subsidiary, CDS Clearing and Depository Services Inc., acts as the central securities depository, securities settlement system and central counterparty for Canada's equity, money market and fixed income (government and corporate) cash markets. CDS's ongoing commitment to minimize risk for market participants and its sophisticated financial risk model<sup>1</sup> have earned it a top global ranking from Thomas Murray, the specialist custody rating, risk management and research firm.<sup>2</sup>

CDS is one of the most efficient central depository and clearing organizations in the world. A pricing study that compared CDS to eight other similar organizations concluded that CDS had the second lowest pricing amongst the group.<sup>3</sup> Furthermore, CDS has an enviable track record of cost efficiency, demonstrated by the fact that its clearing price for exchange trades has been reduced over the past five years by a factor of 18, even though business volume has increased only by a factor of 6.4. Today, the price for processing an exchange trade is less than one cent per trade (after discounts).

CDS is directly regulated by the Bank of Canada, the Ontario Securities Commission (OSC) and the Autorité des marchés financiers (AMF) in Quebec. CDS's clearing, settlement and depository system, CDSX<sup>®4</sup>, is one of only three systems to have been designated by the Governor of the Bank of Canada as a systemically important system in Canada pursuant to section 4 of the *Payment Clearing and Settlement Act*.<sup>5</sup> CDS is recognized as a clearing agency by the OSC pursuant to section 21.2 of the

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<sup>1</sup> CDS's Risk Model may be accessed at [http://www.cds.ca/cdsclearinghome.nsf/Downloads/-EN-CDSFinancialRiskModel-Version6.0/\\$File/CDS+Financial+Risk+Model+Version+6.0.pdf?OpenElement](http://www.cds.ca/cdsclearinghome.nsf/Downloads/-EN-CDSFinancialRiskModel-Version6.0/$File/CDS+Financial+Risk+Model+Version+6.0.pdf?OpenElement).

<sup>2</sup> Thomas Murray's full report may be accessed at:

<http://www.thomasmurray.com/images/stories/documents/cdsrating2011.pdf>.

<sup>3</sup> [http://www.cds.ca/cdsclearinghome.nsf/Downloads/-EN-CSDPricingAnalysis2011/\\$File/Pricing+Analysis+2011.pdf?OpenElement](http://www.cds.ca/cdsclearinghome.nsf/Downloads/-EN-CSDPricingAnalysis2011/$File/Pricing+Analysis+2011.pdf?OpenElement).

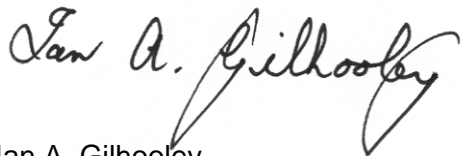
<sup>4</sup> CDSX<sup>®</sup> is a registered trademark of The Canadian Depository for Securities Limited

<sup>5</sup> The other two designated systems are The Large Value Transfer System and the CLS Bank.

<http://www.bankofcanada.ca/financial-system/payments/oversight-and-legislation>. Through such designation, the enforceability of CDSX's rules is protected when dealing with a participant's insolvency.

Ontario *Securities Act*.<sup>6</sup> The AMF has authorized CDS to carry on clearing activities in Québec pursuant to sections 169 and 170 of the Québec *Securities Act*.<sup>7</sup>

Sincerely,



Ian A. Gilhooley  
President and Chief Executive Officer

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<sup>6</sup> [http://www.osc.gov.on.ca/documents/en/Marketplaces/cds\\_20060908\\_amend-rec-desig-ord.pdf](http://www.osc.gov.on.ca/documents/en/Marketplaces/cds_20060908_amend-rec-desig-ord.pdf).

<sup>7</sup> <http://www.lautorite.qc.ca/files/pdf/bourses-oar-chambres/2bi-decis-autor-cds-disp-reconn-revoc-2006pdg-0180.pdf>.

## **CDS response to CSA Consultation Paper 91-402 Derivatives: Trade Repositories**

### ***Trade repositories – one aspect of the global solution***

As CDS presented in its response to the Canadian Securities Administrators (CSA) Committee's first in the series of consultation papers on OTC derivatives (91-401), there are five components to a Canadian solution for the future processing of OTC derivative transactions in the global market.<sup>8</sup> Specifically:

1. Regulatory oversight and capital standards
2. Trade execution on organized markets
3. Standardization
4. Central counterparty (CCP) clearing
5. Central trade repository<sup>9</sup>.

In examining and assessing potential solutions for a trade repository, one must be mindful of all five components. The components are interrelated, with the four operational components resting on the foundation layer of regulatory oversight and capital standards. The CSA Committee is following this approach, examining the various components while building upon the regulatory proposals contained in 91-401. CDS applauds this approach and the industry consultation and regulatory cooperation, both on domestic and international fronts.

CDS believes that the order in which the four operational components are addressed is important. Determining how particular OTC derivatives will be traded has a major influence on who will lead the effort on standardization, how the clearing process will be designed and who will act as the CCP. Without standardization, both in terms of the features of the contracts that govern the relationship between the parties and in terms of the codification of the contract terms and conditions, it would not be possible to trade these derivatives on an organized market, to manage the risks within the contract by clearing through a CCP, or to efficiently input the terms and conditions into a trade repository. Similarly, the scope of the work to be performed by the designated clearing organization and CCP will depend greatly on the degree to which the derivatives in question can be traded on an organized market.

### ***Surrounding architecture for a trade repository***

The ultimate goal of the G-20 initiative is to have all derivative asset classes traded on organized markets with the resultant trades being centrally cleared and novated to a CCP and stored within a trade repository.<sup>10</sup> However, it is generally recognized that the change in market practice will be measured and will depend upon a number of different factors including the asset class and whether associated markets are to be considered global, national, or a combination thereof.

The content and functionality to be contained within a trade repository will also depend upon the surrounding infrastructure. For the information in a trade repository to be relevant, trade details that are

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<sup>8</sup> [http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com\\_20110114\\_91-401\\_gilhooleyi.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category9-Comments/com_20110114_91-401_gilhooleyi.pdf).  
<sup>9</sup> *Supra* note 7. Referred to in previous CDS submissions as "Central data repositories/information warehouses"

<sup>10</sup> The G-20 acknowledged that there may be some non-centrally cleared OTC derivative contracts but they should be subject to higher capital requirements.

input to a trade repository need to be affirmed by both parties to the trade (i.e., legally binding between the parties). A key question is whether this affirmation process is considered to be part of the trade repository functionality or is performed by another part of the overall infrastructure (e.g., a stand-alone trade matching utility, swap exchange facility (SEF), or a clearing system). Currently in the absence of established SEFs, interest rate swap (IRS) trades are frequently affirmed using various middleware systems<sup>11</sup>. Output from the middleware system comprises agreed-upon trade details and formats that are then suitable for input to a clearing house (e.g. LCH.Clearnet) as well as a trade repository, obviating any requirement for trade matching/affirmation functionality to be contained within the trade repository itself. Conversely, absence of this surrounding trade match/trade affirmation functionality would imply that the trade repository itself needs to contain this functionality.

CDS recommends that the assumptions being made by the CSA committee with respect to this surrounding infrastructure be made clear when looking for explicit proposals on the development and operation of a trade repository (i.e., is it assumed that the trade to be input to the trade repository, whether cleared or uncleared<sup>12</sup>, is to come from another part of the infrastructure or is to be entered by one or both of the participants to the trade?). Without explicit guidance on the assumptions to be made regarding the surrounding infrastructure, it is possible that a chosen solution will subsequently prove to be unsuitable for the Canadian environment without extensive, unanticipated modifications.

#### ***Access to information in the trade repository***

Transparency of the OTC derivatives market is a central pillar of the G-20 reforms. To achieve transparency, the G-20 has agreed that all OTC derivative transactions (cleared and uncleared) must be reported to trade repositories. As noted in section 1 of the CSA Committee's consultation paper, such transparency is for both the benefit of the regulators and the public. This is a key point – the trade repository will have multiple customers and as such this will influence the ultimate solution for the Canadian marketplace. CDS believes that there are three important issues that need to be addressed:

1. “Ownership” of the information in the trade repository
2. Access to the information in the trade repository
3. Fees to be paid for access to the trade repository.

The “ownership” issue becomes crucial if a national trade repository is to be developed and implemented. CDS believes that the ownership model needs to be a shared model between the financial industry and the regulators and that an oversight body needs to be created to ensure appropriate governance over the operating model for the trade repository.

The regulators will need full access to the information maintained in the trade repository in order to conduct their oversight role. Through such oversight, market confidence will be bolstered. However, it is envisioned that the public would also have access to a subset of the information in the trade repository.

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<sup>11</sup> Such as MarkitWire, VCON, etc.

<sup>12</sup> For the purposes of this paper, “cleared” means novated to a CCP. “Uncleared” means that the trade is affirmed between the parties to the trade but that the trade remains on a bi-lateral basis.

As noted in the consultation paper, the OTC derivatives market has been historically opaque. Opaque markets result in information imbalances, creating value (or protecting value) for those having greater access to information than others. Opening access to the public will shift a degree of value from the transacting parties to the accessing parties. Trading strategies, hedging motives, etc. will become more apparent. In essence, the information has commercial value (i.e. those who do not have access to the information would presumably be willing to pay for such access).

Access to information and whether or not to charge for access is a complex issue and one that is very relevant to the type of operation that should be put in place for the trade repository (i.e., profit oriented, cost recovery or regulator-operated). Regulators would be accessing data for the benefit of the markets and public generally, without interest or intent in creating further economic value from the information. In light of such, it is assumed that the regulators should be able to access such information without incurring costs themselves, at least in terms of “per transaction” costs.

The CSA currently offers SEDAR<sup>®13</sup> (regulatory filings) and SEDI<sup>®</sup> (insider trading) information at no cost to the investing public but allows market rates to be charged to commercial users of the information. Guidance from the CSA Committee on the acceptability of this type of bifurcated business model is necessary before a final determination can be made on the operating model to be employed.

**CSA Question #1: If the use of a Canadian trade repository were to be mandated, should it be privately developed and operated for profit, privately developed and operated on a not-for-profit basis or should provincial market regulators perform this function directly?**

In answering the question posed by the CSA Committee, it is necessary to determine if there are economic benefits that are created by the introduction of a trade repository or whether the introduction of the trade repository is a form of “public good” that does not require tangible economic benefits (e.g., the availability of SEDAR regulatory filings at no charge to bona fide investors) to justify its development and operational costs. If the trade repository is viewed as form of “public good” for the benefit of the integrity of the Canadian capital markets then the cost of development and operation should be borne by the market regulators with the resultant costs presumably being recovered through a form of charge-back methodology. A charge-back model based upon trades that have a Canadian participant on one or both sides would be relatively easy to implement through regulation. However, since it is likely that there will be a requirement to capture all trading activity in all asset classes that involve the Canadian dollar, the regulators would need to determine who pays for this additional capture, the cost of which is likely to be high in relation to the domestic data capture.

If there are shared economic benefits to the regulators, financial industry and “public” (however defined), then the selected option depends upon the split in economic benefit and an assessment of the most efficient operating model. Consideration could be given to a joint venture initiative between the public and private sector. Development and operation of the trade repository by the private sector would likely produce more efficient results and allow the provincial market regulators to be in a position to focus on the provision of effective oversight over the operator. This would avoid any concerns regarding potential conflicts of interest associated with regulatory authorities performing the dual roles

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<sup>13</sup> Registered trade-mark of the Canadian Securities Administrators.

of operator and overseer. In this situation, the public and private sectors would share ownership of the trade repository and the associated data.

The purely for-profit model of operation would only work if the economic benefits to the financial industry and the public were considerable and would be worth paying for. If the payment model is “imposed” as opposed to a “payment for value received” model then a cost-recovery model would be preferable to the for-profit model.

Lastly, as noted in the consultation report, where a derivatives transaction does not involve a Canadian market participant (and hence *ultra vires* the Canadian regulatory authorities) but is a Canadian referenced derivatives transaction (e.g., underlying in Canadian dollars or a Canadian security), such data would need to be obtained from another jurisdiction. A solution to this issue is for the Canadian-based trade repository to aggregate such data obtained through agreements with foreign trade repositories (likely reciprocal in nature). CDS has proven experience and expertise in dealing with foreign financial market infrastructures, such as that demonstrated through its cross-border link with The Depository Trust and Clearing Corporation, forming the most active and sophisticated inter-depository linkage in the world.<sup>14</sup>

#### ***Trade repository governance and operational guidelines***

Regulators in all jurisdictions will rely on trade repositories to provide accurate data on a timely basis. To facilitate and ensure that trade repositories (as FMIs) meet these requirements, international regulatory standards (through CPSS/IOSCO) have been proposed. The CSA Committee has confirmed it will rely on these standards in developing the Canadian rules for trade repositories.

CDS agrees with the CSA Committee’s direction to develop rules based on international standards. CDS has actively supported the adoption of international standards for FMIs, primarily through the assessment of its current services against existing international standards. CDS has been assessed against the *Recommendations for securities settlement systems* (RSSS) by the Bank of Canada<sup>15</sup> and has conducted self-assessments against the *Recommendations for central counterparties* (RCCP). CDS has also explicitly included compliance with the RSSS and RCCP as one of the key principles in its risk management policies that are approved annually by the CDS board of directors.

#### ***Trade repository legal framework***

CDS fully endorses the suggestion that trade repositories have a clearly defined legal framework and that trade repository rules, procedures and contractual arrangements be supported by applicable laws and regulations. CDS, being a recognized clearing agency, has a clearly defined framework and likewise has rules, procedures and contractual arrangements supported by applicable laws and regulations.<sup>16</sup> It is suggested that a similar model to that applying to CDS be employed for trade repositories.

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<sup>14</sup> Other international relationships include Euroclear France, Japan Securities Depository Center, Inc., CAVALI (Peru) and Skandinaviska Enskilda Banken (Sweden).

<sup>15</sup> <http://www.bankofcanada.ca/wp-content/uploads/2010/05/finalcdsxpaper.pdf>.

<sup>16</sup> Such laws include the various provincial and territorial Security Transfer Acts and Personal Property Security Acts.

CDS's participant agreement, its rules, and procedures (Legal Documents) are accessible on the CDS website. In fact, the CDS Legal Documents as posted on the CDS website are the official and legally binding version.<sup>17</sup> Any amendments proposed to these Legal Documents are subject to a well-defined and transparent review process. This process includes (with some variation depending on the specific document type) review and approval by CDS and its board, and its participants and development subcommittees. In addition, all amendments to CDS's Legal Documents are subject to public review and comment as well as review and approval by CDS's regulators.<sup>18</sup>

### ***Governance – board of directors***

CDS agrees with the CSA Committee's recommendation regarding the composition of a trade repository's board of directors. CDS targets diversity of experience and relevant skills in its directors and by agreement, independent representation on the board is mandatory.<sup>19</sup> While CDS publishes its definition of "independent director", for clarity purposes, it may be worthwhile for the CSA Committee to provide specific guidance on this matter or to specifically require that a trade repository's recognition order address such.

The consultation paper does not discuss board committee composition or mandates. It is recommended that these matters be addressed prior to final rule making. Using CDS as an example, it has three board committees: the governance/human resources committee, the audit/risk committee and the finance committee. Each of the three committees has a formally documented mandate with specific accountabilities.

### ***Governance – risk management***

CDS agrees that a trade repository must have a robust governance regime to ensure effective risk management and to protect the confidentiality of information it maintains. It would be appropriate that a trade repository have a well articulated risk tolerance statement that allows the trade repository and its stakeholders to know the boundaries of acceptable risk taking and to ensure that there are processes and controls to contain its risk exposures within those boundaries. This would assist in balancing commercial interests with the public role as a central storage facility of secure data. The risk tolerance statement would also promote efficiency by eliminating the need to introduce costly controls that attempt to reduce the risk exposure of a trade repository to a level that is not cost justified. Providing for the input of various stakeholder groups, particularly the customers of the trade repository, into the definition of the trade repository's risk tolerance is an important consideration. CDS fully supports the concept of transparency concerning a trade repository's governance framework and operating procedures.

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<sup>17</sup> CDS Participant Rule 1.3.7.

<sup>18</sup> The AMF and the OSC both require any amendments to CDS's Legal Documents to follow a formal Rule Protocol (which forms part CDS's recognition by each regulatory authority). The amendments are also subject to Bank of Canada review via its Regulatory Oversight Agreement with CDS.

<sup>19</sup> Since 1981, via a Pooling Agreement among CDS shareholders.



### ***Governance - chief compliance officer***

CDS agrees with the requirement that trade repositories be required to appoint a chief compliance officer. Compliance with laws and resolving conflicts of interests are vital for an FMI. CDS suggests the following points for consideration by the CSA Committee. First, since appropriate “segregation of duties” is a key element of strong risk and control environments,<sup>20</sup> should the CCO role be a dedicated role (one that cannot also be performed by an existing officer) in order to avoid any actual or perceived conflict of interest? Second, what is considered the appropriate reporting line for a CCO? Is it acceptable that a CCO report to the chief executive officer or should a CCO reporting line be similar to an auditor’s role which reports to the audit committee of the board? If the latter, then what would be the appropriate board committee?

### ***Market transparency and data availability***

It is assumed that it can be generally agreed that the primary function of a trade repository is to store trade information and make such information available to its customers. There are, however, many open questions in terms of the scope of this primary function. Some of these questions include: What specifically is the data that are required to be stored? What regulators should have direct access to the trade repository? Should non-Canadian regulators seeking trade repository data have the same direct access rights as Canadian regulators or should they have indirect access to the trade repository data via the Canadian regulators? Ongoing dialogue regarding these and other similar questions should be carried out through stakeholder consultation, with the final conclusions being open and transparent.

CDS strongly advocates that the trade repository protect the confidentiality of the trading participants in order that competitive advantages are not obtained through preferential treatment. A well-defined and transparent process must be established as to how trade repository data is accessed. CDS recommends that the confidentiality protection it affords its capital markets participants be used as a model for the trade repository.<sup>21</sup>

### ***Operational reliability***

An important measurement of security and reliability of a trade repository is the ability to recover quickly from a business interruption and get back to full functionality; to this end a trade repository must manage its operational risks accordingly. However, the objective of managing operational risks (or any other risk) should be to manage the impact of the occurrence of any risk within the trade repository’s capacity and risk tolerance. Minimizing risk beyond what can be economically justified increases costs and reduces efficiency without commensurate benefit. When considering operational risk, CDS has found that a coordinated, rigorous and comprehensive system of internal control is the single most important aspect of its management of operational risk. Similar to the management of CDS’s current lines of business, specific emphasis on internal controls should be applied to trade repositories.

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<sup>20</sup> See, chapter 4 “Internal Control – Integrated Framework”, Committee of Sponsoring Organizations of the Treadway Commission (September, 1992).

<sup>21</sup> CDS Participant Rule 3.6. “Confidentiality”.

CDS agrees that trade repositories must have business continuity and disaster recovery programs. A trade repository should, on an ongoing basis, test its ability to fully recover from an interruption to the operation of its services and systems. This will provide a high level of confidence that service interruptions will be at a minimum if a disaster occurs.

CDS also agrees that a trade repository should have comprehensive backup facilities such as a full backup data centre in order to replicate production data for technology resiliency.

A trade repository must have a set of documented processes to be followed if it experiences a significant outage. Business continuity plans should be documented and relate to the business side of recovery and complement a corporate technology disaster recovery plan and problem management process. The goal of these plans would be to ensure that the trade repository can fully recover from any interruption to its operation, and to minimize service interruptions to its customers if a disaster occurs. The consultation paper suggests that a two-hour recovery time be applied which is consistent with recovery times for CDS's core depository, clearing and settlement systems.

### ***Access and participation***

A continuing theme for trade repositories is transparency and this should also apply in regards to the standard for access and participation. CDS agrees that such standards be public.<sup>22</sup> Given that all OTC derivative trades, cleared and uncleared, are to be sent to the trade repository, it is essential that all trading participants have unfettered access and connectivity to the trade repository. Being able to leverage existing access and connectivity to a central FMI such as CDS would be of significant economic benefit to the trading participants. The utility of a trade repository depends on the collection of robust, full, and complete information. There should be clear protocols as to how information is to be submitted to the trade repository (e.g., which side of the transaction is required to submit to the trade repository and which side is expected to affirm the details of the transaction and in what timeframe).

As previously described, a clear understanding of the surrounding architecture to the trade repository is essential to the design of the protocols for trade submission to a trade repository.

### ***Safeguarding of data***

Safeguarding of information is a critical element for the trade repository's operations as it is the custodian of commercially sensitive and systemically important OTC derivatives data. The data should be stored in a fully contained, secure environment and not exported to other environments in order to maintain the integrity and confidentiality of the data.

In addition to protecting the data stored in the trade repository, consideration should be given to security surrounding the information sources for the data. Trade data will likely flow from multiple sources into the trade repository, requiring a variety of systems interfaces to be employed (such as automated exchange facilities, messaging and web interfaces). Irrespective of the interface, data communication security will be paramount and industry best practices should be followed.

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<sup>22</sup> CDS Participant Rule 2 deals with participation in CDS.

The trade repository should have an appropriate perimeter security infrastructure to protect and preserve the confidentiality, integrity and availability of its systems,<sup>23</sup> security for its physical environment, and appropriate back-up and disaster recovery systems. Likewise as the CSA Committee recommends, the trade repository's safeguarding processes should be subject to periodic independent reviews.

The consultation paper provides that information sharing with affiliated entities would be strictly prohibited. Some consideration should be given as to whether the trade repository must be operated by a single purpose legal entity to avoid risk contagion with its affiliates and any potential conflicts of interest.

### ***Trade repositories as market participants***

Confidence in the capital markets is based upon the premise that market participants will function within generally accepted rules of engagement. Securities and derivatives laws are at the pinnacle of these rules. While these laws provide the foundational framework for market participant behaviour, mere existence of such laws has not always been sufficient to guarantee that behaviour will be within acceptable limits. To this end, regulatory bodies have been created to enforce, oversee and provide guidance for these laws.

Market participants include a wide spectrum of entities and individuals, including FMIs, and by definition, include trade repositories.<sup>24</sup> Various rules apply to each market participant but generally more specific rules apply to FMIs in light of the key role they play within the market as a whole. The failure of an FMI to comply with applicable rules can have serious implications for the capital markets.<sup>25</sup> In light of these potential serious implications, FMIs are subject to specific attention, tailored as required to their respective role.

Codification of trade repositories in the definition of market participant flows naturally from the fact that trade repositories are FMIs. A trade repository should be subject to not only market participant rules generally but also to specific rules that apply to FMIs, tailored for their type of business. While CDS agrees with the CSA Committee's recommendation that where necessary, provincial securities or derivatives legislation should be amended to include *approved* trade repositories, CDS is of the view that a clearer, stronger and more definitive position may be appropriate.<sup>26</sup> For instance, in Ontario, *designated* trade repositories are included in the definition of market participant. However, unlike clearing agencies and exchanges which are subject to mandatory recognition in order to carry on

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<sup>23</sup> Including logical access protection (such as firewalls and intrusion detection systems, authentication mechanisms, and a virtual private network for remote access). The challenge with access to the trade repository is that the system complexity is directly proportional to the breadth of access required (i.e. multiple entities, regulations, etc.)

<sup>24</sup> As referred to in Appendix A of the consultation paper.

<sup>25</sup> "[T]hey can pose significant risks to the financial system and be a potential source of contagion, particularly in periods of market stress." Section 1.1 of the CPSS-IOSCO Consultative Report "Principles for financial market infrastructures" (March 2011).

<sup>26</sup> "Central banks, market regulators, and other relevant authorities should clearly define and disclose their regulatory, supervisory, and oversight policies with respect to FMIs." (emphasis added). From Responsibility C as listed on page 4 of the CPSS-IOSCO Consultative Report "Principles for financial market infrastructures" (March 2011).

business in Ontario, trade repositories are designated on a voluntary basis.<sup>27</sup> As a consequence of the key role that trade repositories play in the derivatives market, designation should not be granted according to a voluntary application process.

#### ***What transactions must be reported?***

CDS agrees with the recommendation that all OTC derivatives trades must be reported to the trade repository. The question of how all currently outstanding OTC derivative trades (i.e. existing prior to implementation of the reporting rule) are to be reported requires further analysis. It is accepted that a primary aim of the trade repository is to provide an aggregated, holistic view of the Canadian OTC derivatives market and this can only be done with all active trades being reported. In terms of active trades pre-dating the reporting rules, a 180 day window to report to the trade repository seems reasonable. However, further consideration should be given as to the mechanics of how the terms of these trades would be reported.<sup>28</sup> Additionally, while the CSA Committee's recommendation on exempting trades that expire within one year balances a required holistic view of the market with the effort required to report, in light of increasingly volatile markets, the CSA Committee may wish to consider to provide such exemptive relief only where the trade falls under a specified threshold (e.g. trades under a certain notional value or some other criteria).

#### ***What information must be captured and reported?***

In order for a complete and holistic view of exposures affecting a particular market, a trade repository must be able to obtain transactional data between counterparties domiciled within the home jurisdiction, counterparties on a cross-jurisdictional basis (i.e. a domestic counterparty and a non-domestic counterparty), and two non-domiciled counterparties where the underlying product being traded is determined by the regulators to be within the scope of the requisite data capture. Based on the wide breadth of reporting coverage, in all likelihood a trade repository will be receiving data from multiple sources and it is quite probable that these sources will send the same data to data repositories in differing jurisdictions (as various jurisdictions establish their domestic trade repositories). From an efficiency perspective, it makes sense that a common approach be used in the format of the data being reported. Sources will be able to use one formatting standard as will all parties within the value chain (including the regulatory authorities). Furthermore, the development of one reporting standard will draw on the collective knowledge and experience of the global market and ensure future amendments are consistent across all jurisdictions.

In addition to the potential cost benefits of derivatives systems dealing with standardized data (a key tenet of the global solution to the handling of OTC derivatives), risk management capabilities will be also be enhanced (a primary driver for the G20 commitments). For instance, the adoption of a unique legal entity identifier (LEI) will provide the capability for all market participants to improve the quality of their internal reference data, thus leading to an improvement in the measurement and recognition of counterparty risk. It will also provide ease of reporting to regulators that will allow regulators to better monitor systemic and counterparty risks, track exposures and potential risks across multiple asset

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<sup>27</sup> S. 21.2.2(1) "The Commission may, on the application of a person or company proposing to carry on business as a trade repository in Ontario, designate the person or company..." *Securities Act* (Ontario).

<sup>28</sup> For instance, the agreed-upon format in which such data is provided to the trade repository.

classes and jurisdictions. Other standardized identifiers (such as product type) will also provide enhanced tracking and risk management capabilities. Market participants and regulatory authorities will have the ability to monitor entity-wide exposures and trading activity, follow transactions through their lifespan and determine product concentrations. In summary, CDS believes that the use and implementation of an internationally accepted data standardization methodology (such as that being developed for LEIs) should be mandated for the Canadian marketplace.

CDS continues to track progress on international developments in this regard and notes significant industry agreement in terms of LEIs. In particular, a global trade association group composed of the Securities Industry and Financial Markets Association (SIFMA) and various other associations have proposed that the Association of National Numbering Agencies (ANNA) through its network of local national numbering agencies be a key partner in the solution for registering, validating and maintaining LEI's for issuers and obligers in their home market.<sup>29</sup> CDS supports this recommendation and believes that leveraging the global issuance infrastructure that is currently in place for the issuance of securities identifiers (i.e., International Security Identification Numbers or ISINs) is a cost effective and efficient means for a successful LEI solution for the Canadian marketplace. CDS, as Canada's national numbering agency and as a member of ANNA, is ideally positioned to fulfill this role in the Canadian market place.

#### ***When are transactions required to be reported?***

#### **CSA Question #2: What is required to enable Canadian derivatives market participants to be able to report derivatives transaction information in real time and how long will it take to achieve this functionality?**

The answer to this question varies according to the surrounding infrastructure to the Canadian trade repository.

If an SEF was in place for a particular asset class and the SEF provided standard output messages once a confirmed trade was created between two parties, the Canadian trade repository would be able to subscribe to these messages and update its data warehouse appropriately. Similarly, if there was a defined link between a trade matching utility and trade repositories, the Canadian trade repository would be able to pick up the output messages from the trade matching utility and update its data warehouse appropriately. There is not enough information at this time to estimate how long it would take to provide this functionality.

If market participants were required to input directly into the Canadian trade repository separate and apart from a trading and/or trade matching utility, a robust infrastructure between the derivative market participants and the Canadian trade repository would be required. CDS currently provides this type of robust infrastructure for all cash market and repo activity. This infrastructure, with additional development effort, could be used to report OTC derivative trades to a Canadian trade repository, whether or not CDS was selected as the operator of the trade repository. Based on the experience with building a similar infrastructure for the fixed income repo project, the expanded infrastructure could probably be in place within six-nine months. Development work would also be required within the

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<sup>29</sup> Paper titled "Global Legal Entity Identifier – Industry's Process and Recommendations" (July 2011) <http://www.sifma.org/issues/item.aspx?id=8589934643>

participants' systems. There is not enough information available to estimate the scope and effort of this development work.

### ***Block trades: exception to real time reporting***

#### **CSA Question #3: What is the appropriate block trade threshold for the Canadian market?**

As outlined in the consultation paper, there are a variety of mechanisms by which the publication of block trades may be effected while still maintaining market integrity. Each of these mechanisms should be examined for each asset class using available Canadian derivatives market data. From a rule making perspective, a flexible approach should be undertaken so as to facilitate changes to the threshold mechanism over time.

Equally important is the ability of the trade repository functionality to capture the rules on the creation of the block trade threshold and to only publish block trade information in accordance with these rules.

#### **CSA Question #4: What is the appropriate publication delay for block trades?**

A starting point is to consider the publication delay used for the listed derivatives market block trades, however, the specific attributes of the derivatives product and the market in which it trades should be taken into consideration in determining an appropriate publication delay.

#### **CSA Question #5: Would a uniform block trade threshold across asset classes be acceptable or should thresholds be determined based on asset class? If block trade thresholds should be determined based on asset class, what thresholds would be suitable for specific asset classes?**

As each asset class (and products within each asset class) has its own market trading characteristics, thresholds should be based on asset class. Functionality within the trade repository needs to be able to handle this requirement.

#### **CSA Question #6: If block trade thresholds are determined by asset class and given the changes inherent in liquidity conditions, how often should these be assessed? (As per the Commodity Futures Trading Commission's (CFTC's) two tests proposal for example?)**

Fundamentally, determining the frequency for assessing the appropriateness of block trade thresholds depends on the market characteristics for a particular derivatives product. These characteristics can only be determined through analysis of the underlying market data (such as would be contained in the trade repository). It is likely that only after the trade repository is operational that the regulatory authorities will have sufficient timely and relevant data with which to analyze for the purposes of determining the frequency of assessment of block trade thresholds. Until the trade repository commences operations and a full data set is available, it will be incumbent upon Canadian counterparties to propose an initial assessment frequency.

### ***Access to confidential trade repository information***

CDS agrees that only part of the trade repository's data should be made available to the public. The data has commercial value and unwarranted disclosure could cause financial harm to a derivatives

market participant as well as be a catalyst to market instability. Likewise, CDS acknowledges that from a regulatory oversight perspective, full access to the trade repository's data is required. As such, transparent rules and procedures should govern the principles and processes by which a trade repository provides access to its data (for instance, the use of appropriate authentication mechanisms).

CDS encourages the CSA Committee to work with international regulators to eliminate any uncertainty as to the breaching of confidentiality obligations of a non-reporting counterparty. All jurisdictions should enact rules which provide that where it is mandatory that affirmed trades be reported to a trade repository, the reporting counterparty cannot be held liable to a non-consenting counterparty for a breach of any confidentiality provisions regarding such trades.<sup>30</sup> Furthermore, standardized and bespoke derivatives contracts should all contain terms allowing for such reporting.

As a primary customer of the trade repository, the Canadian regulators will have direct access to data in the trade repository. However, it remains to be determined how and under what circumstances non-Canadian regulators would have access to the trade repository's data. In Ontario, provided a determination of confidentiality is made by the Securities Commission, information flows to and from the trade repository are exempt from disclosure regardless of freedom of information legislation.<sup>31</sup> It is less clear how a Canadian trade repository's data will be treated by non-Canadian regulators. Furthermore, the means of access by a non-Canadian regulator warrants examination. Will a non-Canadian regulator be permitted direct access to the trade repository or will they be required to obtain the data indirectly from their Canadian regulatory counterparts? CDS recommends that formal memorandums of understanding (MOUs) be agreed to between Canadian regulators and their international counterparts for information sharing purposes.

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<sup>30</sup> As CSA Committee has noted, s. 154 of the Ontario *Securities Act* is an example of such a provision.

<sup>31</sup> CDS agrees with the CSA Committee that similar provisions should be enacted in other Canadian jurisdictions.