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

c/o:

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**Re: Canadian Securities Administrators (“CSA”) Consultation Paper 91-402 –
Derivatives: Trade Repositories**

Dear Sirs/Madams:

The Canadian Electricity Association (“CEA”) is pleased to provide the following comments on the CSA’s Consultation Paper 91-402, entitled *Derivatives: Trade Repositories* (“CP 91-402”). CEA appreciates the opportunity to engage the CSA as it seeks to establish a regulatory framework for the over-the-counter (“OTC”) derivatives marketplace in Canada.

I. Introduction

CEA is the national forum and voice of the evolving electricity business in Canada. CEA members generate, transmit and distribute electrical energy to industrial, commercial, residential and institutional customers across Canada every day. From vertically integrated electric utilities, to power marketers, to the manufacturers and suppliers of materials, technology and services that keep the industry running smoothly -- all are represented by this national industry association.

CEA members are commercial hedging end-users of OTC derivatives

CEA members are committed to providing a reliable supply of electricity at affordable and stable rates. To that end, CEA members must cost-effectively manage operational and commodity market risks in order to keep the lights on for their customers.

Those CEA members which engage in OTC derivative transactions do so primarily for purposes of hedging commercial risks, thereby insulating customers from price volatility in energy

markets. Hedging behaviour varies greatly across CEA's membership, depending on the electricity market structure within a particular province and the commercial function performed by a given market participant – whether generating, transmitting and selling electricity at wholesale, purchasing electricity, distributing electricity to retail customers, or some combination thereof. Participation in OTC derivative markets is a valuable and effective means for many CEA members to manage price risks inherent in their core business – the physical delivery of energy commodities. CEA members thus fit the profile of quintessential commercial end-users in OTC derivative transactions.

II. General Comments

This filing marks the first instance of CEA engagement in CSA's consultation process around proposals for enhanced regulation of the OTC derivatives market. Accordingly, prior to addressing the specific issues raised in CP 91-402, CEA wishes to briefly respond to certain issues raised in the public comments submitted to the CSA on Consultation Paper 91-401 ("CP 91-401") on OTC Derivatives Regulation in Canada.

1. CEA strongly supports the provision of exemptive relief for commercial hedging end-users of OTC derivatives.

CEA supports the CSA's fundamental objective of regulating OTC derivative transactions to reduce systemic risk and abuse in the marketplace. However, CEA stresses that commercial hedging in energy markets represents a nominal share of the national derivatives marketplace. As commercial end-users and non-financial entities, CEA members do not engage in the OTC derivative market in a manner which poses sufficient systemic risk concerns.

CEA therefore wishes to echo many of the comments submitted in response to CP 91-401, which emphasized that a regulatory framework for the OTC derivatives marketplace in Canada ought to focus primarily on those financial entities and professional market participants which are the source of systemic risk. Numerous commenters called for regulators to grant exemptions to commercial end-users from a suite of requirements which are anticipated to be mainstays of OTC regulatory regimes established in Canadian jurisdictions in the future (e.g. mandatory clearing, electronic trading, and margin and/or collateral requirements).¹ In particular, several commenters observed that carve-outs are particularly appropriate for hedging end-users engaged in commodity and energy markets, as this group poses no systemic risk and may be adversely impacted by onerous compliance requirements, with the end result potentially being increased rates for customers in the general public. CEA fully supports these comments and respectfully requests that any regulatory action pursued by the CSA is consistent with them.

Moreover, while CEA has inherent concerns about the capital and infrastructure investments necessary to comply with such requirements as mandatory clearing and margin or collateral, it is also important to note that the CSA is contemplating OTC derivative regulatory action at a time when electricity sector participants are facing tremendous demands for investment in existing and new electricity infrastructure. In April 2011, the Conference Board of Canada

¹ See comments submitted by, *inter alia*, TMX Group Inc., Fidelity Investments Canada ULC, Investment Industry Association of Canada, Global FX and Canadian Bankers Association.



released a report entitled *Canada's Electricity Infrastructure – Building a Case for Investment*.² This study concluded that the electricity sector is expected to invest almost \$295 billion from 2010 to 2030 in order to maintain existing generation, transmission and distribution assets and to meet growth in consumer demand.

As noted in the study, the \$15 billion average annual investment requirement is the highest in the sector's history and thus presents a multitude of challenges for CEA members to overcome. Closing the infrastructure gap will be sufficiently difficult in itself and any impediments to meeting this challenge risk compromising CEA members' ability to provide a reliable, low-cost supply of electricity which Canadian consumers have come to expect as a given.

In the absence of clear exemptions for commercial hedging end-users in regulations adopted by Canadian regulators, CEA members may be constrained in their ability to make priority investments in electricity infrastructure. Such constraint would represent a major opportunity cost, with resources necessary for bolstering grid reliability instead diverted towards compliance with burdensome requirements for mandatory clearing or collateral. Given that commercial end-users represent a tiny fraction of the national derivatives market and present minimal systemic risk, CEA is not convinced that the benefits derived from uniform application of regulatory requirements to all OTC derivative market participants would justify the costs involved.

CEA therefore strongly encourages the CSA to avoid any regulatory action on OTC derivatives which places an undue burden on electricity sector participants and constrains their ability to make necessary investments in existing and new infrastructure. CEA believes that the most effective means for fulfilling this objective is by providing commercial hedging end-users clear exemptions from excessively onerous requirements, including mandatory clearing and margin or collateral posting.

III. Specific Comments

With respect to the proposals on trade repositories set forth in CP 91-402, CEA offers the following comments.

CEA appreciates the basis of the CSA's view that reporting all OTC derivative transactions to an approved trade repository is necessary to reduce systemic risk, achieve market transparency and improve the availability of transaction and aggregate market data information.

Nevertheless, CEA is concerned that mandating the reporting of all OTC derivative transactions in real-time may impose significant costs on commercial hedging end-users and their customers. While the compliance burden associated with a basic reporting requirement for transaction data appears manageable, the call for ultimately requiring real-time reporting of all transactions raises serious challenges for end-users like electricity sector participants.

Real-time reporting of relevant transaction data to a central repository necessitates the use of sophisticated automated reporting systems. In general, however, electricity sector participants lack such systems capability, as they do not maintain a large segment of their business dedicated to managing OTC derivative transactions. Any limited resources available for these

² This report was an independent project commissioned by CEA. The report is available at: <http://www.conferenceboard.ca>



purposes do not at all approach the scale or level of customization utilized by financial entities. Acquiring the technological capability to report transaction data in real-time would therefore require substantial costs and a lengthy timeframe for electricity sector participants. Under the proposals outlined in CP 91-402, these costs would be imposed upon all electricity sector participants that employ OTC derivatives to hedge their commercial risks, including those entities which may only use OTC derivative products on rare occasions and those regulated entities which are required to pass on their operating costs to ratepayers.

Unlike financial entities, engagement in OTC derivative transactions is not a core business function of end-users. Regulatory schemes for OTC derivatives envisioned by the CSA therefore ought not to treat end-users as financial entities. Imposing an equivalent reporting burden on both financial entities and end-users does not constitute a measured approach to reducing systemic risk in the OTC derivatives market, nor is it likely to achieve the intended benefits in a manner which justifies the costs to be incurred. Indeed, it may have the alternative effect of provoking unintended consequences for electricity sector participants and their customers, including increased rates.

CEA believes that any requirements for reporting relevant OTC derivative transaction data to trade repositories should minimize the process burden for commercial hedging end-users as much as possible. CEA respectfully offers the following recommendations to help ensure that any solutions crafted by Canadian regulators will be workable and effective for end-users:

1. Exempt end-users from requirements to report transaction data in real-time and provide them with a reasonable reporting timeframe.

CEA questions the need for commercial hedging end-users to report their OTC derivative transactions in real-time. End-users pose minimal systemic risk to the OTC derivative marketplace and represent a tiny fraction of all transactions executed. CEA members are not certain what will be gained by requiring end-users to adhere to the same rigorous real-time reporting requirements as large financial entities with exponentially greater risk exposures, as the volume of transactions reported by financial entities will vastly outweigh the volume of end-user transactions. CEA thus believes that an exemption for end-users from real-time reporting requirements is appropriate and will not undermine the basic goal of achieving greater transparency in OTC derivative markets.

However, CEA recognizes that greater availability of transaction and aggregate data is a simple and effective means of improving transparency and stability in the OTC derivative market. CEA maintains that increased transparency and stability can still be achieved through the imposition of less onerous reporting requirements on end-users. For these entities, CEA encourages the CSA to consider more reasonable timeframes for reporting OTC derivative transaction data – for example, on a quarterly basis.

In addition, CEA likewise believes that inter-affiliate transactions by end-users should be exempted from real-time reporting requirements. The operations of commercial hedging end-users may span across several branches of a larger corporate family. Depending on market conditions, an end-user may be compelled to shift risk from one affiliate to another in order to hedge effectively. The particular systemic risk exposure associated with such transactions is negligible and the incremental value to regulatory authorities of



receiving the applicable transaction data is likely inconsequential. Accordingly, CEA believes that a real-time reporting exemption for inter-affiliate transactions is warranted.

2. Absent an exemption from real-time reporting requirements, provide end-users with a menu of low-cost options to facilitate such reporting.

If the CSA is committed to mandating real-time reporting for all OTC derivative transactions, end-users ought to be granted various compliance options which do not require the purchase, development and maintenance of sophisticated supporting infrastructure. Examples of potential options include direct feeds or web-based templates/interfaces.

3. Provide a reasonable timeframe for end-users to adjust to the new reporting system.

Regardless of any decision to grant end-users exemptions from real-time reporting requirements, ample time must be afforded to transition to an unfamiliar reporting regime. For market participants and oversight authorities alike, the proposal to regulate OTC derivatives represents an ambitious charting of new territory. Participants and any trade repositories to be established must therefore be granted an appropriate period of time to acquire the capabilities necessary for the new reporting system to function.

CEA supports CSA taking a measured approach to phasing-in the new reporting system and refraining from the imposition of burdensome requirements until it is clear that the competent engagement of all market participants, including trade repositories, is feasible.

In step with this principle, CEA also supports the 180-day phase-in period for reporting pre-existing transactions following the effective date of the reporting rules and the exemption for pre-existing transactions terminating or expiring within one year of the effective date of new reporting rules, as proposed by CP 91-402.

4. Proceed with the proposal to exempt pre-existing transactions terminating or expiring within one year of the effective date of the new reporting rules from the applicable reporting requirements.

CEA supports this recommendation and believes it is consistent with efforts to reduce the process burden for end-users.

5. Proceed with the proposal to require financial intermediaries to bear the reporting onus in transactions with end-users.

CEA supports this recommendation and believes it is consistent with efforts to reduce the process burden for end-users.

6. Proceed with the proposal to permit transaction counterparties to elect the reporting party for transactions involving two end-users.

CEA supports this recommendation and believes such flexible approaches are critical to reducing the process burden for end-users.

7. In seeking to harmonize requirements for reporting transaction data with requirements adopted by U.S. regulators and/or trade repositories, avoid duplicative and onerous regulatory burdens for end-users in Canada.



In view of the international nature of electricity markets in North America, CEA members routinely transact business with counterparties in the United States. As noted in both CP 91-401 and CP 91-402, numerous rulemakings have been completed, are ongoing or are contemplated for purposes of implementing the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (“the *Dodd-Frank Act*”). CEA members have monitored activity associated with the *Dodd-Frank Act* since the inception of the legislation. Based on developments to date, CEA members anticipate that compliance with certain provisions in the Act – including the reporting of OTC derivative transaction data to U.S. regulators and/or trade repositories – may be necessary in order to maintain the ability to participate in U.S. electricity markets.

CEA therefore requests that, in seeking to harmonize with the U.S. system, Canadian regulators adopt a flexible approach for end-users to fulfill reporting requirements for OTC derivative transaction data. This might involve, for example, permitting Canadian end-users to comply with reporting requirements of a Canadian trade repository by submitting data reported to a U.S.-based trade repository or regulator. CEA believes that this type of flexible approach would benefit both the end-user (by avoiding duplicative reporting burdens) and the applicable authority in Canada (by providing the data necessary for achieving greater market transparency and stability).

IV. Conclusion

Effective regulatory oversight of the OTC derivative marketplace in Canada will involve maintaining a proper balance between achieving a high level of market transparency and stability, while enabling end-users to continue using OTC derivatives as an important tool in hedging commercial risk and insulating customers from any price volatility in energy markets. CEA trusts that the recommendations presented in this filing will assist the CSA in developing rules for the reporting of OTC derivative transaction data that will strengthen market oversight without unduly burdening commercial hedging end-users and the customers we serve.

CEA appreciates the opportunity to provide comments on CP 91-402 and looks forward to continue working with the CSA on this and future proposals.

Respectfully submitted,



Pierre A. Guimond
President and Chief Executive Officer

