



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

June 15, 2012

Dear Sirs and Mesdames:

On April 13, 2012, the Canadian Securities Administrators (“the Securities Administrators”) issued for comment *CSA Consultation Paper 91-405 – Derivatives: End-User Exemption* (the “Paper”). Central 1 Credit Union (“Central 1”) welcomes this opportunity to provide the Securities Administrators with comment on the proposals set out in the Paper and to overview the experience of credit unions as arms-length derivatives market participants, in support of their exemption from the proposals.

Central 1 is one of the largest cooperatives in Canada. It provides wholesale financial services, liquidity management, payments processing, and trade associational services to credit unions in British Columbia and Ontario, credit unions which hold \$81.7 billion in assets and comprise roughly 3.1 million Canadians. In the aggregate, the Canadian credit union system comprises more than 350 credit unions with combined assets of \$140 billion, serving more than 5.1 million Canadians.

Eligibility Criteria for End-User Exemption – Credit Unions

It is Central 1’s understanding that the end-user exemption is “intended to be available to market participants that are not in the business of derivatives trading, but trade in OTC derivatives to mitigate commercial risks related to their business [...] [and] employ OTC derivatives trading for hedging rather than speculative purposes.” Canadian credit unions fit within the intent of this exemption, in spite of being categorized as financial institutions – a category of market participant that the proposed exemption criteria carves out from end-user exemption eligibility as the paper states “there is no objective way to define what would constitute a small financial institution that could be exempted without impacting the OTC derivatives market in Canada.”

Central 1 acknowledges the concern expressed in the Paper that providing industry exemptions could risk defeating the purpose of the proposed regulatory framework as it would be difficult to



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measure the impact of such an exemption on the overall market. However, Central 1 is of the view that this risk could be mitigated if the Securities Administrators build sufficient flexibility into the end-user exemption approval process, flexibility that would enable the framework to be administered from a risk-based perspective. Under this model, the onus would be on the financial institution(s) to demonstrate that their exemption would not pose a material risk to the OTC derivatives market in Canada. Applying the framework on this basis would ensure that the intent of the exemption is upheld, while ensuring that those market participants that would otherwise be eligible for an exemption are not arbitrarily dismissed because they fall within the financial institutions category.

Credit unions in Canada are required to be members of a credit union central in all but one province; in Ontario all but a dozen of its 120 credit unions belong to Central 1. Each credit union central provides its member credit unions with wholesale financial services, liquidity management, payments processing, and trade associational services. Central 1 is a central credit union that supplies, inter alia, wholesale financial services to its member credit unions in British Columbia and Ontario. One of the services that Central 1 provides to its members is derivatives products. These products enable credit unions to hedge the interest rate risk and currency risk associated with their retail-oriented deposit taking and lending activities. The overwhelming majority of these transactions would be considered 'plain vanilla' interest rate swap contracts between the credit union and Central 1. Central 1 itself offsets the risk of these contracts, together with those derivatives that it transacts for its own balance sheet with other participants in the financial markets. As part of this process, Central 1 ensures that it has up-to-date ISDA agreements with its counterparties, CSA agreements with its counterparties. Central 1 is also currently examining clearing through the LCH or CME.

In contrast, member credit unions are quite small (only two hold more than \$10 billion in assets) and are not engaged in complex business activities. Every member credit union provides security to Central 1 by way of a General Security Agreement, which also provides security for clearing, settlement and credit facilities, including those for derivative activities. Virtually none of these credit unions will have eligible securities on hand, as their liquid assets are managed on a pooled basis by Central 1.

As such, credit unions, while financial institutions, are not in the business of trading derivatives. Credit unions primarily use OTC derivatives to mitigate the risks of their business which fits the definition of hedging purposes. In addition, even collectively, credit unions are not systemically important players in the derivative markets. Requiring credit unions to report all their derivative transactions directly is expected to be cost prohibitive and may pose undue burden to the point that many credit unions may no longer be able to afford to use derivatives to manage their business risks. Most credit unions do not have the sophisticated treasury systems that are required to track straight through trade processing and reporting, nor do they have pricing engines. For the most part, they rely on their central credit union for settlement, resets and pricing.

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In Central 1's opinion, an end-user exemption for credit unions should be granted, notwithstanding that credit unions are financial institutions. At the very least, there should be an end-use exemption for derivatives between a credit union and its Central credit union. Central 1 is of the view that all relevant information surrounding these transactions will be reported by the central credit unions themselves, as central credit unions would be appropriately classified as a "market participant" for derivatives within the credit union system.

With respect to questions 5, 6 and 7, Central 1 is supportive of the proposals. That is to say, credit unions that are granted an end-user exemption would self-certify with notice to their regulator, maintain appropriate records and require that their board of directors approve the use of derivatives as a hedging tool, to demonstrate appropriate hedging compliance. In closing, Central 1 would be pleased to provide the Securities Administrators with any additional information as may be required in consideration of comments provided above with respect to the Paper.

Should you have any questions please do not hesitate to contact me at cmilne@central1.com or by telephone at 604-730-6307.

Yours truly,



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