STATE STREET
GLOBAL ADVISORS.

State Street Global Advisors, Ltd.
770 Sherbrooke Street West
Suite 1200
Montreal, Quebec
H3A 1G1

www.ssga.com

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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

c/o
John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8
Fax: (416) 593-2318
e-mail: jstevenson@osc.gov.on.ca

RE: **Canadian Securities Administrators Consultation Paper 91-405 re: Derivatives- end-user exemption**

Dear Sir or Madam

State Street Global Advisors Ltd. ("SSgA") welcomes the opportunity to comment on Canadian Securities Administrators Consultation Paper 91-405 regarding the proposed exemption for end-users of derivatives (the "Exemption") from regulations promulgated under 91-401 requiring among things, central clearing and reporting of OTC derivatives positions (the "Proposed Legislation").

SSgA is a wholly owned subsidiary of State Street Corporation, a US Financial Holding Company. It is a recognized leader and ranks as a major investment manager in Canada. Our clients are located across the country and include corporations, public funds, foundations, endowments, life insurance companies and government agencies. In conjunction with SSgA's other investment centers and sister companies worldwide, SSgA in Canada provides clients with integrated solutions that combine investment management, transition management, trust, custody, recordkeeping and administrative services.

In its capacity as an investment advisor or trustee, SSgA is one of the largest end users of foreign exchange products in Canada. In calendar year 2011 SSgA executed over 24,000 separate foreign exchange transactions, with aggregate notional exposure to all currencies equal to USD 127 billion with 13 broker-dealers acting as market makers in the Canadian markets in various foreign exchange products.

With respect to the questions put forth in the Exemption, SSgA comments as follows:

Q1: Do reporting obligations create any barriers to participation in the derivatives market that would be unique to end-users or a category of end users? Please provide a description of the potential issues that end-users may face.

We support reporting of derivative positions as an alternative to full compliance with the Proposed Legislation so long as the reporting obligations are structured in a way to avoid undue burden on end-users. There are two primary concerns we have with reporting.

First, we would be concerned if any derivative positions we report are publicly attributed to SSgA, or if our derivatives position is disclosed anonymously, but in a manner where the derivative position could be attributed to SSgA readily through "reverse engineering" or other financial or algorithmic analysis. This is a concern because although derivatives positions we enter into are for hedging purpose, such hedge positions could disclose the underlying long or short position of our managed accounts, which is of course proprietary.

Second we are not sure if it is intended that the reporting is expected to be in real time or historical on a periodic basis. If the former, this could create an operational burden that may be difficult for end-users. It may be possible that the broker-dealer trading with the end-user relying on the Exemption is in a better position to report to the regulator as they will have their own reporting obligations and will more likely have bespoke operations and infrastructure to address reporting than any end-user relying on the Exemption.

Q2: Are the end-user eligibility criteria proposed by the Committee appropriate?
Q3: Should alternate or additional criteria be considered?

Generally we believe the criteria are reasonable. However, there are two aspects that require further clarification or modification to achieve the reasonable result intended by the Exemption.

First, we think it should be clarified that a "financial institution" does not include a pooled or separately managed investment account, so long as the separately managed investment account is not used to evade application of the Regulation by a proprietary account of a "financial institution". This clarification seems reasonable especially if either of the following criteria are established: (i) the investment account is subject to some other regulation that mitigates systemic risks inherent in derivative trading (*e.g.* a fund subject to N.I. 81-102[1]); or (ii) the investment account only engages in the use of derivatives to hedge risk (*e.g.* interest rate, currency, or credit risks) of instruments or securities that are *actually held* by the investment account. In the case of "(ii)", it is expected that although the underlying instrument may be held for speculative purposes, the derivatives itself is purely a hedge and mitigates some of the risks of speculation, and in this way looks much like an end-user hedging a physical commodity. This approach suggested by "(ii)" would also be consistent with the example in the definition of *"hedge or hedging"* that was provided in the

[1] *See e.g.* National Instrument 81-102 §§ 2.7; 2.8

Exemption[2].

Furthermore, if investment accounts are subject to the Proposed Regulation, compliance, whether by increased collateral requirements or fees associated with clearing, could result in increased operational costs and reduce overall return of the investment portfolio. For smaller investment accounts this could be a sufficiently large detriment to result in the avoidance of derivative hedging activity, which would seem to run counter to the intended results of the proposed regulation and although it may reduce systemic risks in *derivative* markets, does result in increased overall systemic risk in the *investment* markets. As an alternative an investment fund may seek to avoid taking a position in instruments needing to be hedged altogether. This also would be an unintended consequence of the Proposed Regulation with negative consequences. Although avoiding such investments may reduce investment risk for a particular portfolio, it may result in other negative consequence for the investment fund such as reduced return on investments and loss of diversification. Further, this avoidance of purchasing instruments needing a hedge could result in decreased liquidity in a particular instrument class.

Second, there is a criteria that each entity claiming end-user status must be acting for their *own* account. We think it should be clarified that the entity seeking to rely on the Exemption *can be* managed by a professional investment advisor, who is *not* the entity seeking reliance on the Exemption, although the professional investment advisor may be able to provide some logistical support to the end-user with respect to the Exemption as part of it standard services, including reporting derivatives positions or providing notification of reliance on the Exemption.

Q4: Are the Committee's recommendations to exclude the specified end-user eligibility criteria from consideration appropriate?

We agree with exclusion of the additional criteria for the Exemption. In particular we want to note that some of the derivative products used as a hedge may not be standardized. In some cases it is the bespoke nature of the products that provide the hedge if the underlying investment is non-standard.

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[2] The term "hedging" could mean the entering into of a derivatives transaction or a series of derivatives transactions, and the maintaining of the position or positions resulting from the transaction or series of transactions if:

1. the intended effect of the transaction or series of transactions is

    a) to offset or reduce the risk related to fluctuations in the value of an underlying interest or a position, or of a group of underlying interests or positions; or
    b) to substitute a risk to one currency for a risk to another currency, provided the aggregate amount of currency risk to which the hedger is exposed is not increased by the substitution;

2. the transaction or series of transactions results in a high degree of negative correlation between changes in the value of the underlying interest or position or group of underlying interests or positions being hedged and changes in the value of the derivatives with which the value of the underlying interests or positions is hedged; and

3. there are reasonable grounds to believe that the transaction or series of transactions no more than offsets the effect of price changes in the underlying interest or position, or group of underlying interests or positions, being hedged.

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Q5: Is the Committee's proposal that the market participant itself determine its qualification for an exemption and provide notice to the regulator of its intention to rely on the exemption appropriate?

We agree with the approach suggested by the CSA so long as the criteria for establishing eligibility is sufficiently clear. We believe that sufficient clarity would exist if the comments of SSgA (including our response to Q1 and Q2) are incorporated in the final version of the regulation.

Q6: Is the proposed process to be followed by eligible end-users wishing to rely on the exemption appropriate?

In the case of investment accounts, we agree with the proposal suggested by the CSA so long as the level of detail of derivative trading activity presently maintained and reported to shareholders or beneficiaries (whether from an accounting perspective, profit and loss or otherwise) is sufficient to satisfy the record keeping requirement. We also would suggest that this record keeping may best be maintained by the dealer who already has reporting obligations and will most likely have better infrastructure than any entity claiming end-user exemption.

Q7: Is the Committee's proposal to require board of directors' approval of the use of OTC derivatives as a risk management tool to demonstrate hedging compliance appropriate for non-registrant entities?

Yes, we think that obtaining board of directors (or trustees) could be structured appropriately to not materially increase operational burden to an entity claiming reliance on the Exemption. This seemed to be the approach suggested by the CSA in the commentary regarding regulator notification preceding Q6. In the case of investment funds general fiduciary standard would require material investment decisions be subject to periodic review and approval by a funds governing body. For regulated investment funds procedures should already be in place for board approval of financial statements[3], fund performance[4], change of auditors[5], or disclosure of material changes[6], and in addition there is the safeguard of shareholder approval for fundamental changes to a registered investment fund.[7]

We believe any such requirement of board approval would be most efficient if the general hedging strategy that incorporates derivatives, or material edits thereto, is approved by the board rather than requiring each hedging transaction to be approved by

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[3] *See e.g.* National Instrument 81-106 §2.5
[4] *See e.g.* National Instrument 81-106 §4.5
[5] *See e.g.* National Instrument 81-106 §13.2
[6] *See e.g.* National Instrument 81-106 §11.2
[7] *See e.g.* National Instrument 81-102 §5.1

the board of directors. Also, the CSA could consider requiring additional disclosures in a prospectus, offering memoranda or other investment fund disclosure documents to address the hedging strategy employed by an investment fund.

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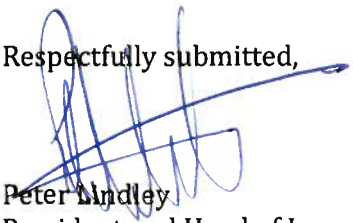
Thank you for the opportunity to provide comments and recommendations regarding the Exemption.

Respectfully submitted,



Peter Lindley
President and Head of Investments, State Street Global Advisors, Ltd.