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**June 17, 2013**

**Re: Canadian Securities Administrators ("CSA") Consultation Paper 91-407  
Derivatives: Registration (the "Consultation Paper")**

## **INTRODUCTION**

Canada Pension Plan Investment Board ("CPP Investment Board") is pleased to provide its comments on the Consultation Paper dated April 18, 2013 published by the Canadian Securities Administrators Derivatives Committee (the "Committee") relating to the proposal for the regulation of key OTC derivatives market participants through the implementation of a registration regime.

CPP Investment Board is a member of the Canadian Market Infrastructure Committee ("CMIC"). CPP Investment Board is a signatory to the CMIC letter being submitted in relation to the Consultation Paper, as it has been to all previous CMIC letters to the CSA. However, this particular Consultation Paper raises a number of issues of serious and unique concern to CPP Investment Board. Accordingly, CPP Investment Board concluded that it was important to submit its own letter in addition to the CMIC letter in order to address the unique issues raised for CPP Investment Board by the CSA registration proposals.

## SUMMARY OF SUBMISSION

CPP Investment Board does not believe that the Large Derivative Participant (LDP) category is either necessary or appropriate for Canada given the characteristics of the Canadian market. No evidence supporting the need to create such a registration category has been provided. Specifically, CPP Investment Board strongly urges the CSA to reconsider any proposal that would cause CPP Investment Board to be subject to registration as a LDP. We do not see any need for CPP Investment Board to be designated as a LDP. Our reasons, in summary, are as follows:

1. CPP Investment Board is a unique organization created by an Act of Parliament to manage the assets of the Canada Pension Plan. The activities of the CPP Investment Board are overseen by an independent board of directors and the CPP Investment Board is accountable to the Parliament of Canada and to the federal and provincial finance ministers.
2. CPP Investment Board is subject to a comprehensive statutory framework pursuant to which the assets it manages are required to be invested in accordance with the provisions of the *Canada Pension Plan Investment Board Act* and the accompanying regulations, as well as with the by-laws and investment policies of CPP Investment Board.
3. CPP Investment Board adheres to the highest form of best practices in both its risk management and corporate governance.
4. CPP Investment Board is only engaged in OTC derivatives as a buy-side end-user, enters into transactions only with other sophisticated counterparties and conducts no market-making activities of any nature.
5. No reasons for imposing various possible registration requirements on CPP Investment Board have been provided in the Consultation Paper or elsewhere.
6. There has been no evidence, anecdotal or otherwise, that would suggest or require the imposition of a registration regime on CPP Investment Board with respect to its involvement in the OTC derivatives market.

In summary, the existing accountability to federal and provincial finance ministers, the existing statutory framework to which the CPP Investment Board is subject, the best practices standards adopted by the CPP Investment Board in relation to both corporate governance and risk management represent, as a whole, a robust and complete legal, regulatory and compliance regime which has been recognized globally as setting a world class standard for national pension plans and funds. As a result of these characteristics, we submit that there is no need for provincial securities regulators to impose a registration regime on the CPP Investment Board in relation to its OTC derivatives activities.

In addition, CPP Investment Board is very concerned about the creation of a burdensome Canadian registration regime as a whole. CPP Investment Board has a global investment mandate in order to achieve the returns required to support the retirement needs of Canadians and does so in a manner that is not constrained by or overly dependent upon Canadian economic growth. Our ongoing access to global OTC derivative products is a critical component of executing, at attractive pricing, on that global investment mandate, and foreign banks are often the only providers of many of these derivative products. Canada should not develop a registration regime that deters foreign counterparties from offering these OTC derivatives to sophisticated Canadian counterparties like CPP Investment Board. Market liquidity is essential to mitigate systemic risk. CPP Investment Board submits that registration requirements for foreign counterparties could materially compromise liquidity (and attractive pricing) in the small Canadian market, and thereby, actually, inadvertently increase systemic risk.

## BACKGROUND AND DESCRIPTION OF CPP INVESTMENT BOARD

### General

CPP Investment Board was incorporated as a federal crown corporation by the *Canada Pension Plan Investment Board Act* (the "CPPIB Act") and manages the assets of the Canada Pension Plan (the "CPP") transferred to it (the "CPP Fund"). CPP Investment Board invests the assets of the CPP not immediately required to pay benefits. CPP Investment Board is responsible for managing the CPP Fund in accordance with the CPPIB Act.

CPP Investment Board received its mandate from the Canadian federal and provincial governments. In addition to being accountable to the Parliament of Canada and to the federal and provincial finance ministers who serve as the CPP's stewards, the CPP Investment Board also reports to Parliament through the federal finance minister who tables our annual report in the House of Commons. The CPP Investment Board is governed and managed independently of the CPP and at arm's length from governments with a singular objective: to maximize returns without undue risk of loss. CPP Investment Board is not an agent of the Canadian federal government or of any provincial governments.

### Governance Model and Risk Management

The aim of CPP Investment Board is to preserve and enhance the maximum-strength governance model in which the CPP Investment Board operates at arm's length from governments with an investment only mandate, overseen by an independent board of qualified professionals. CPP Investment Board and its Board of Directors take very seriously their responsibilities to execute this governance model transparently and with the highest standard of care in order to preserve the model's exceptional advantages in managing the assets of the CPP Fund solely for the benefit of CPP participants and beneficiaries.

CPP Investment Board is very focused on maintaining best practice standards in respect of its governance policies and authorities. The CPP Investment Board operates with extremely high levels of disclosure and transparency, including publishing its investment policy and public equity holdings on its website and reporting publicly to Canadians in line with regulatory requirements for public companies even though it is not a reporting issuer.

With CPP Investment Board gaining an increasingly global investment profile, our Board of Directors focuses particular attention on the management of the various risks to which the organization may be exposed. The Board ensures that all key risks of the CPP Investment Board enterprise are identified, that effective processes are in place to manage these risks, that the highest calibre personnel are hired to comply with such enterprise risk management and that the processes are diligently executed by management. All risks are managed within an Enterprise Risk Management (ERM) framework with the goal of ensuring that the risks we take are commensurate with and rewarded by long-term benefits.

Our ERM framework is based on: a strong governance structure including a risk-aware culture, risk policies, defined risk appetite and risk limits; processes for identifying, assessing, measuring, mitigating, monitoring and reporting all key existing and emerging risks; and control practices with independent assurance that these practices are working properly. Risk governance at CPP Investment Board is accomplished by individual officers and committees. Our systems ensure close adherence to internal approval thresholds depending on size and scope of risks pursuant to total active risk limit policies and protocols. The Board of Directors is responsible for oversight of CPP Investment Board's efforts to achieve the mandated maximum rate of return, without undue risk of loss. To this end, the Board of Directors is responsible for ensuring that management has identified all

key risks and established appropriate strategies to manage them. Committees of our Board of Directors also have risk-related responsibilities.

The President and CEO is, by way of delegation by the Board of Directors, accountable for all risks beyond those explicitly controlled by the Board. The responsibility for risk management is distributed throughout the organization starting with the Senior Management Team (SMT), which consists of the President and CEO and the CEO's direct reports. The SMT considers the full spectrum of inherent and emerging risks and ensures close alignment of our risk management efforts with our business strategy and plans. The leaders of each department are responsible for appropriately managing the risks assumed within their areas of responsibility and within their risk limits. The Chief Operations Officer is accountable for the Investment Risk department which measures, monitors and reports investment risks independently from the investment departments. This separates risk monitoring from investment management. The Chief Financial Officer, on behalf of the SMT, oversees the ERM framework. The Internal Audit department also plays an important role as it provides independent assurance that controls and mitigants are properly designed and operating effectively. The culture of CPP investment Board is by nature very risk aware, with staff constantly considering risks in their daily activities.

#### Use of Derivatives

OTC derivatives are a very important product used by CPP Investment Board to generate value-added investment returns and to limit or adjust market, credit, interest rate, currency and other financial exposures.

The global investing mandate of CPP Investment Board will be critical in helping to sustain the CPP. The provision of adequate retirement income to a growing Canadian population that is both aging and living longer is vitally important to Canadians. Using OTC derivatives to invest globally and manage risks is essential to ensure that investment returns are not limited to growth in the relatively small Canadian economy. Enhancing liquidity available to Canadian OTC derivatives end-users such as CPP Investment Board is an important objective to preserve attractive pricing and thereby enhance investment returns but is also an important goal for regulators seeking to manage systemic risk. Regulatory measures that inhibit liquidity will compromise CPP Investment Board's global mandate and could also lead to the unintended consequence of increasing systemic risk.

However, as set forth above, our use of OTC derivatives and our management of the associated risks is effected within a risk aware culture by enterprise risk management systems, subject to a best practices corporate governance model. In addition, we deal only with sophisticated counterparties. These carefully constructed "checks and balances" produce, in our view, a regime which represents "state of the art" and responsible usage of OTC derivative products.

#### Highest Creditworthiness

The *Canada Pension Plan* (the "CPP Act") established the Canada Pension Plan Account (the "CPP Account") within the Consolidated Revenue Fund of the federal government. The CPP Act provides that any amounts standing for the credit of the CPP Account that exceed the immediate obligations of the CPP Account are transferred to the CPP Investment Board. The federal government can make a request for payment by the CPP Investment Board into the Consolidated Revenue Fund out of the CPP Fund assets held by the CPP Investment Board. Under the statutory framework, however, CPP Investment Board is at all times legally entitled to retain and maintain assets that have a fair market value of not less than the liabilities of the CPP Investment Board. As a result, under the statutory framework, only assets having a fair market value in excess of the liabilities of the CPP Investment Board are available to the federal government to satisfy the obligations of the federal government under the CPP.

Furthermore, CPP Investment Board has received the highest possible credit ratings from ratings agencies; it is currently rated "AAA" by Standard & Poor's, "Aaa" by Moody's and "AAA" by DBRS.

### Summary

In summary, therefore, CPP Investment Board operates in a robust risk management environment with very significant and sophisticated internal corporate governance procedures, monitored closely by its Board of Directors and various committees of its Board, is subject to a unique and carefully constructed statutory framework, is fully accountable to the Parliament of Canada and operates with full public transparency and with the highest creditworthiness. Furthermore, since CPP Investment Board only participates in the OTC derivatives market as a buy-side end-user dealing with other sophisticated parties, and does not engage in market-making activities, we strongly submit that CPP Investment Board does not require the imposition of a registration regime by provincial securities commissions.

### **SPECIFIC RESPONSES TO THOSE CONSULTATION PAPER QUESTIONS OF DIRECT RELEVANCE TO CPP INVESTMENT BOARD**

The answers below primarily address those specific CSA questions that raise unique issues for the CPP Investment Board and supplement the answers provided in the CMIC letter to which we are a signatory.

#### **Questions & Responses**

**Q2: What is the appropriate standard for determining whether a person is a qualified party? Should the standard be based on the financial resources or the proficiency of the client or counterparty? If the standard is based on financial resources should it be based on the net assets of the client or counterparty, gross annual revenues of the client or counterparty, or some other factor or factors?**

Based on the description of CPP Investment Board presented above, we submit that CPP Investment Board clearly should meet an objective definition of a qualified party without any inquiry into or specific requirements relating to proficiency.

**Q4: Are derivatives dealer, derivatives adviser and LDP the correct registration categories? Should the Committee consider recommending other or additional categories?**

CPP Investment Board submits that the LDP category is not an appropriate registration category for Canada. It would appear possible that CPP Investment Board could be considered a LDP. However, as solely a buy-side, end-user market participant dealing only with other sophisticated counterparties, CPP Investment Board plays no role in "making" derivatives markets. It is therefore unclear what risk is being addressed if CPP Investment Board was required to register as an LDP. As fully described elsewhere in this letter, the existing accountability to federal and provincial finance ministers, full public transparency of its operations, robust risk management and corporate governance practices, and unique and carefully constructed statutory framework, mean, in total, that designation as an LDP is inappropriate and unnecessary for CPP Investment Board.

**Q6: The Committee is not proposing to include frequent derivatives trading activity as a factor that we will consider when determining whether a person triggers registration as a derivative dealer. Should frequent derivatives trading activity trigger an obligation to register where an entity is not otherwise subject to a requirement to register as a derivatives dealer or a LDP? Should entities that are carrying on frequent derivatives trading activity for speculative purposes be subject to a different registration trigger than entities trading primarily for the purpose of managing their business risks?**

CPP Investment Board is of the view that the factors to be considered for registration purposes should be based on the role of a participant rather than how often a participant trades. The frequency with which an end-user participates in the market is not relevant. If frequency of trading was included as a factor and therefore frequent hedgers (who are often end-users) are caught, this would have the result of discouraging hedging (which is inconsistent with minimizing systemic risk).

**Q9: Are the factors listed for determining whether an entity is a LDP appropriate? If not what factors should be considered? What factors should the Committee consider in determining whether an entity, as a result of its derivatives market exposures, could represent a serious adverse risk to the financial stability of Canada or a province or territory of Canada?**

Since no equivalent category exists, to our knowledge, in any G-20 jurisdiction other than the U.S., we are concerned about creating a unique registration regime feature in a smaller market like Canada. Therefore, as set out in our answer to question 4 above, it is CPP Investment Board's view that the LDP category is not appropriate for Canada.

**Q11: Is it appropriate to impose category or class-specific proficiency requirements?**

CPP Investment Board strongly submits that proficiency requirements, whether by way of category or class-specific requirements or general requirements for individuals, should not be imposed on an OTC derivatives non-market making, purely buy-side, end-user market participant such as CPP Investment Board. Given CPP Investment Board's robust risk management, corporate governance and well developed human resource policies, such requirements are unnecessary and would impede our ability to execute on our global mandate. We can see no benefit in imposing such requirements and we are not aware of such requirements being required of end-users in any jurisdiction around the world. Furthermore, CPP Investment Board is not aware of any market conduct issues that such requirements would be intended to address. Such requirements are appropriate for the retail securities market with respect to individuals within securities firms that are dealing with unsophisticated investors. Proficiency is not an issue that requires regulation among sophisticated counterparties.

**Q12: Is the proposed approach to establishing proficiency requirements appropriate?**

See our answer to question 11 above.

**Q14: Are the requirements described appropriate registration requirements for derivatives dealers, derivatives advisers and LDPs? Are there any additional regulatory requirements that should apply to all categories of registrants? Please explain your answers.**

CPP Investment Board is of the view that the registration requirements relating to LDPs are not appropriate. The goals of the G-20 commitments relating to OTC derivatives are to improve transparency in the derivatives market, mitigate systemic risk and protect against market abuse. Those risks are addressed by appropriate trade reporting and clearing requirements. See also our answers above to questions 4 and 9.

**Q19: The Committee is recommending that foreign resident derivative dealers dealing with Canadian entities that are qualified parties be required to register but be exempt from a number of registration requirements. Is this recommendation appropriate? Please explain.**

We do not believe that registration of foreign resident derivative dealers is an appropriate requirement. Imposing additional registration requirements for foreign resident participants may well severely restrict liquidity in the Canadian market. Canadian regulators should be respectful of home

jurisdiction regulatory compliance. A significant portion of liquidity in the Canadian market is provided by non-domestic participants.<sup>1</sup> If foreign resident derivative dealers dealing with qualified parties are required to register, even though they may be exempt from a number of registration requirements, there is a serious risk that they will choose not to deal with Canadian market participants. Such an outcome could very well mean that a number of important derivative products would no longer be available, at attractive pricing, to CPP Investment Board since in certain cases such products are only offered by foreign banks. This would have the effect of reducing liquidity in the Canadian market, making it more difficult for non-market making end-users like CPP Investment Board to enter into hedges and, thereby, lead to the unintended consequence of increasing systemic risk in Canada.

**Q21: Should foreign derivatives dealers or advisers not registered in Canada be exempt from registration requirements where such requirements solely result from such entities trading with the Canadian federal government, provincial governments or with the Bank of Canada?**

Exemption from registration solely on the basis of a derivatives dealer trading with the Canadian federal government, provincial governments or with the Bank of Canada is not appropriate. Such an approach would bifurcate market liquidity for sovereign entities versus other end-users. Having said that, if the CSA chooses to introduce an exemption for sovereign entities, then CPP Investment Board should receive equal treatment. Although CPP Investment Board is not a sovereign entity, CPP Investment Board is, as noted above, a crown corporation under its incorporating federal statute. Furthermore, the presence of credit ratings at the highest available level combined with the statutory right of CPP Investment Board to at all times maintain assets that will satisfy its liabilities places it in a very favourable position from a creditworthiness perspective. On this basis, any such exemption should extend to the CPP Investment Board. Such a result would parallel the qualification of CPP Investment Board as an accredited investor under National Instrument 45-106 as a result of the fact that it is a crown corporation.

**Q22: Is the proposal to exempt crown corporations whose obligations are fully guaranteed by the applicable government from registration as an LDP and, in the circumstances described, as a derivatives dealer appropriate? Should entities such as crown corporations whose obligations are not fully guaranteed, foreign governments or corporations owned or controlled by foreign governments benefit from comparable exemptions? Please provide an explanation for your answer.**

As mentioned above in our responses to questions 4, 9 and 14, CPP Investment Board does not agree with the creation of an LDP category of registration. However, if exemptions are provided, then CPP Investment Board should be included in the exempt category because of its status as a crown corporation, its highest available credit ratings and the unique statutory right of the CPP Investment Board (only relevant in exceedingly remote circumstances) to maintain sufficient funds at all times to meet CPP Investment Board liabilities.

**Q23: Are the proposed registration exemptions appropriate? Are there additional exemptions from the obligation to register or from registration requirements that should be considered but that have not been listed?**

See responses to questions 21 and 22 above.

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<sup>1</sup> For example, as of February 1, 2011, almost half of all Canadian dollar denominated interest rate swaps are not entered into by any of the big six Canadian banks. Source: CMIC "Data Analysis Report", February 1, 2011; Bank for International Settlements Triennial Survey June 2010.

Thank you for the opportunity to provide our comments to the CSA on this important subject.

CPP Investment Board hopes that its comments are useful in the development of the regime for the regulation of the OTC derivatives market and that the CSA takes into account the practical implications for all market participants who will be subject to such regulation.

CPP Investment Board would be pleased to discuss the contents of this response with representatives from the CSA.

**Canada Pension Plan Investment Board**

Per:

  
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