



Pension Investment  
Association of Canada

Association canadienne des  
gestionnaires de caisses de retraite

May 13, 2015

Josée Turcotte  
Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
comments@osc.gov.on.ca

Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, tour de la Bourse  
Montréal, Québec H4Z 1G3  
Fax : 514-864-6381  
consultation-en-cours@lautorite.qc.ca

Dear Ms. Turcotte and Me Beaudoin,

**Re: Proposed NI 94-101 – Mandatory Central Counterparty Clearing of Derivatives**

This submission is made by the Pension Investment Association of Canada (“PIAC”) in reply to the request for comments by the Canadian Securities Administrators (the “CSA”) regarding 94-101 – Mandatory Central Counterparty Clearing of Derivatives (the “Clearing Rule”).

**Background**

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and management of over \$1.3 trillion in assets on behalf of millions of Canadians. PIAC's mission is

to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

## **Comments on Clearing Rule**

### Pension Plans do not Increase Systemic Risk

PIAC welcomes the opportunity to comment on the Clearing Rule. It is not PIAC's intention to provide comments on every point raised within the Clearing Rule, rather, PIAC's comments will be centered on specific matters concerning pension plans and the establishment of the appropriate clearing regime within Canada. Specifically, PIAC is concerned with the definition of a "financial entity" and the inclusion of pension funds within such definition.

In terms of systemic risk, it is important to understand that pension plans, whether large or small, primarily use derivatives for hedging purposes. This means that aggregate derivatives exposure will overstate the risk from derivatives positions as it will only capture one side of the investment strategy. This basic defensive orientation, combined with the pension industry's very high implicit credit ratings and long-term investment horizon, allows pension plans to assume the risks of derivatives exposures that might be more difficult for other derivatives market participants to support during periods of market stress. Pension plans, even the largest ones, are neither highly levered nor heavily reliant on short-term financing, which are key characteristics of market participants most likely to pose systemic risks. Additionally, pension plans are not subject to redemptions by their members. It is PIAC's opinion that the use of derivatives by pension plans is more likely to reduce systemic risk and increase liquidity for the overall market as pension plan counterparties allow derivative dealers to offset some of their risk with high-quality, low risk entities. Requiring pension plans to clear their transactions, while allowing other entities to remain outside of the clearing regime with respect to their hedged transactions could discourage participation in OTC derivatives markets, which could undermine investment risk management objectives as well as be detrimental to overall market robustness.

In support of the notion that pension plans do not add to systemic risk, PIAC notes the consultative document from the Financial Stability Board and the International Organization of Securities Commissions dated March 4, 2015, Proposed Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions (the "Consultation Document"). The purpose behind the Consultation Document is to outline the characteristics of those entities that are systemically important. Within the Consultation Document, the FSB and IOSCO have asked whether pension plans should be excluded from the definition of Non-Bank Non-Insurer financial entity, stating one rationale for a pension plan exclusion "is that they pose low risk to global financial stability and the wider economy due to their long-term investment perspective."

The Consultation Document also outlines five basic indicators regarding systemically important institutions: size, interconnectedness, substitutability, complexity and global activities. It is

PIAC's opinion that no pension plan exhibits the five basic indicators and consequently, pension plans are not institutions that increase systemic risk within the global financial system.

PIAC would also note that Canadian pension plans are subject to comprehensive regulation by federal and provincial governments, in terms of solvency, governance and risk management.

#### Pension Plans that are Small Market Participants

PIAC submits that the inclusion of pension plans within the Financial Entity definition is extremely burdensome for pension plans, especially pension plans with little or limited participation within the derivatives market. The actions of these smaller market participant pension plans are extremely similar to derivatives transactions entered into by corporate end-users. These pension plans are typically hedging a valid commercial risk within their business, which varies from foreign exchange transactions related to international investments, to ultimately the risk of being able to pay pensions to the beneficiaries of the pension plan. PIAC notes the exemption provided to corporate end users that is not available to pension plans due to the inclusion of pension plans within the Financial Entity definition within the Clearing Rule. PIAC would suggest that all pension plans should be able to avail themselves of the end user exemption and pension plans should be removed from the definition of Financial Entity. However, if the CSA does not agree with this approach, at a minimum the Clearing Rule should be amended so that smaller market participant pension plans are exempt from the clearing mandate within the Clearing Rule.

PIAC notes that smaller market participants may have a difficult time obtaining services from a clearing member, a necessary relationship required for market participants to clear derivatives transactions. This issue is compounded if the number of clearing members offering client clearing services is reduced.

We appreciate the opportunity to comment on the Model Rule. Please do not hesitate to contact Robert Cultraro, Chair of the Investment Practices Committee (416-345-5476; Robert.Cultraro@HydroOne.com) if you wish to discuss any aspect of this letter in further detail.

Yours sincerely,



Dan Goguen  
Chair