Office of the Superintendent of Financial Institutions Canada
255 Albert Street
Ottawa, Ontario
K1A 0H2
Canada

Attention: Patrick Tobin - Capital Specialist, Bank Capital

Re: Follow up to ISDA’s response on the OSFI Consultation on Draft Guideline E-22 – Margin Requirements for Non-Centrally Cleared Derivatives

Dear Mr. Tobin:

The International Swaps and Derivatives Association, Inc. (“ISDA”) appreciates this opportunity to respond to questions you raised on December 2, 2015 and December 11, 2015 regarding ISDA’s response of November 24, 2015 (the “ISDA Comment Letter”) to the draft version of Guideline E-22 (the “Draft Guideline”) on margin requirements for non-centrally cleared derivatives transactions published by the Office of the Superintendent of Financial Institutions Canada (“OSFI”) on October 19, 2015.

For ease of reference, we have repeated the questions you asked and organized our responses accordingly. Capitalized terms used herein that are not defined herein have the meanings given to such terms in the Draft Guideline.

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1 Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 68 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association’s web site: www.isda.org.
1. **Comment:** In the ISDA Comment Letter, ISDA stated it was concerned about the scope of the definition of “financial entity” and suggested that OSFI explicitly exclude treasury affiliates and SPEs from the definition of Covered Entity. Please provide suggestions for other specific entities that you believe should be excluded from the Draft Guideline.

**Response:** ISDA continues to urge OSFI to carve-out entities that are not considered systemically important and generally enter into derivatives to hedge commercial risk from the scope of the Draft Guideline. We propose language along the following lines to address concerns with unintended entities falling within the definition of “financial entity”:

“A Covered Entity will not include (i) covered bond guarantors (including any such guarantors organized as partnerships or trusts) that enter into non-centrally cleared derivatives in connection with the issuance of covered bonds; (ii) treasury affiliates that undertake hedging activities on behalf of affiliates within a corporate group; (iii) any special purpose entity (“SPE”) established for the purpose of financing a specific pool or pools of assets or underwriting a specific set of risk exposures, in each case, by incurring indebtedness; provided that the indebtedness of the SPE, including obligations owing to the SPE’s swap counterparties, is secured by the specific pool or pools of financed assets; (iv) any SPE established by an investment fund for the purpose of acquiring or holding real estate or other physical assets on behalf of or at the direction of the investment fund; (v) any SPE or other entity established for the purpose of acquiring or investing directly or indirectly in real estate or other physical assets; and (vi) any collective investment vehicle established for the purpose of investing directly or indirectly in real estate or other physical assets.”

The addition of the underlined language would also address a concern of Canadian pension plans that their real estate investment entities (non-financial entities established to acquire or invest in real estate and using derivatives solely for hedging purposes) have the potential to become a Covered Entity in the event that “consolidated group” includes the pension plan parent. We believe specificity is particularly important given that market participants will be called upon to give representations as to their status for purposes of the Draft Guideline and appreciate the opportunity to suggest additional granularity to aid market participants in determining whether they qualify as “financial entities.”

Additionally, ISDA continues to urge OSFI to carve-out non-financial entities from the scope of Covered Entities (the approach taken by the US prudential regulators). Alternatively we would submit that either hedging transactions be excluded from the notional threshold for non-financial entities, or the notional volumes of non-financial entities (for example real estate investment entities) should not be aggregated with the notional of their financial entity parent (the approach taken in Europe under EMIR and the EU NFC- concept where the notional amount of a “consolidated group” is defined by combining the gross notional positions across other non-financial entities within the group, excluding financial entities).
2. **Comment:** In the ISDA Comment Letter, ISDA requested that OSFI also carve-out from the scope of the Draft Guideline (i) novations of grandfathered transactions and (ii) new non-centrally cleared transactions resulting from portfolio compressions of grandfathered transactions. Please describe ISDA’s proposal for addressing portfolio compression of both new transactions and grandfathered transactions.

**Response:** ISDA reaffirms its request that OSFI carve-out from the scope of the Draft Guideline new non-centrally cleared transactions resulting from portfolio compressions of grandfathered transactions (“legacy transactions”). However, ISDA recognizes that new non-centrally cleared transactions resulting from compressions of both legacy transactions and transactions which are subject to mandatory margin requirements should also be subject to the margin requirements provided for in the Draft Guideline.

3. **Comment:** In the comment letter submitted by ISDA and the Japan Financial Markets Council (JFMC) to BCBS/IOSCO on December 8, 2015 regarding changes to settlement issues required so that Japanese and other Asian markets are not unfairly disadvantaged, ISDA stated that “in case of cross border business, a T+2 settlement cycle could only work if the ideal circumstances were in place which we think unlikely.” However, in the ISDA Comment Letter, ISDA indicated that a T+2 settlement cycle is only problematic for smaller counterparties who aren’t subject to the IM rules. While ISDA requests that the initial calculation and call of variation margin and initial margin occur at T+2 and the settlement within another +2, after such initial calculation and call, ISDA does not indicate that there is an issue with a daily calculation and call and T+2 settlement.\(^2\) I would like to confirm that ISDA’s submission to OSFI regarding the timing of variation margin and initial margin contained in the ISDA Comment Letter continues to be your position and that ISDA’s concern with respect to a T+2 settlement cycle is with respect to smaller counterparties who aren’t subject to the margin rules.

**Response:** ISDA continues to request greater flexibility around the timing requirements for the calculation, call and exchange of initial margin and variation margin. ISDA is particularly concerned with the timing of the first margin call for a new transaction, which can depend on several factors (including the time of execution of the transaction, the location of the parties, whether the parties are in different calendar days at the time of execution and whether the day of execution is a business day for both parties). We therefore continue to propose that any mandatory timelines accommodate the variety of factors that can impact the call and settlement timeframes and that the obligation to calculate, call and

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\(^2\) Specifically, the ISDA Comment Letter states “We propose that the initial calculation and call of variation margin should occur either on or before the business day following the day of execution or the second business day following the day of execution if Asian operations are involved. Thereafter, variation margin should be calculated and called on a daily basis as contemplated in paragraph 16 of the Draft Guideline. For counterparties that are also subject to a requirement to exchange initial margin, the exchange of variation margin should be operationally possible within one day following the calculation and call, or within two days following the calculation and call if European or Asian operations (including custodians or sub-custodians) are involved. For counterparties that are not subject to initial margin (and who therefore are unlikely to have the same developed infrastructure), the settlement of variation margin may require up to three business days following the calculation and call.”
exchange margin be within the timelines outlined below “or as soon as reasonably practicable thereafter.”

**Variation Margin:**

We continue to propose that the initial calculation and call of variation margin occur either on or before the business day following the day of execution or the second business day following the day of execution if Asian operations are involved. Thereafter, variation margin should be calculated and called on a daily basis as contemplated in paragraph 16 of the Draft Guideline.

While counterparties that are subject to a requirement to exchange initial margin should be able to exchange variation margin within one day following the calculation and call, or within two days following the calculation and call if European or Asian operations (including custodians or sub-custodians) are involved, counterparties that are not subject to initial margin (and who therefore are unlikely to have the same developed infrastructure) may require up to three business days for the settlement of variation margin following the calculation and call.

**Initial Margin:**

We continue to propose that the initial calculation and call of initial margin should occur no later than the second business day following the day of execution. Thereafter, initial margin should be calculated and called on a daily basis as contemplated in paragraph 22 of the Draft Guideline. The exchange of initial margin should be within two business days following the calculation and call (as contemplated in paragraph 23).

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ISDA appreciates the opportunity to submit our responses to your follow-up questions. We would welcome the opportunity to further clarify any questions that OSFI may have. Please feel free to contact Fred Quenzer at fquenzer@isda.org or 212-901-6052 or the undersigned at kdarras@isda.org or 212-901-6031 if you have any additional questions.

Yours sincerely,

[Signature]

Katherine Darras
General Counsel, Americas
ISDA