

By Email – [robin.edger@ontario.ca](mailto:robin.edger@ontario.ca)

May 7, 2012

Mr. Robin Edger  
Office of the Assistant Deputy Minister  
Ministry of Consumer Services  
Consumer and Business Policy Unit  
777 Bay Street, 5<sup>th</sup> Floor  
Toronto, Ont.  
CANADA  
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Dear Mr. Edger:

**Re: Proposal for Reform of the Personal Property Security Act re  
Cash Collateral**

The purpose of this letter is to communicate the support of the International Swaps and Derivatives Association (**ISDA**) for the proposal of the Ontario Bar Association Personal Property Security Law Subcommittee entitled *Perfecting Security Interests in Cash Collateral* (**OBA Proposal**) and to respond to your letter to us dated April 5, 2012.

*About ISDA*

Since its founding in 1985, ISDA's purpose has been to make over-the-counter (OTC) derivatives markets safe and efficient. It has more than 820 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. ISDA members include the Canadian chartered banks and other major financial institutions, as well as many other Canadian financial and commodities market participants, such as major pension plans and governments. ISDA has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

Effective and enforceable collateral arrangements significantly reduce credit and legal risk in these important markets and are therefore an integral aspect of safe and efficient markets. One of ISDA's major initiatives is to obtain each year for jurisdictions

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across the globe legal opinions addressing the effectiveness of collateral arrangements, including cash collateral arrangements. Canadian market participants are both significant collateral takers and providers in derivatives and securities financing markets.

## *Your Questions*

1. *Based on our knowledge of the PPSA and financial markets, do we believe you have characterized the issue correctly?*

Largely yes. As we elaborate below, this is not an issue restricted to derivatives markets. We would urge you do adopt a comprehensive solution for all cash collateral regardless of the type of transaction that is secured. Also, the crux of the issue is the need for legal certainty of a first priority.

Your identification of the cash collateral issue as being important to derivatives market participants is correct. A high level of certainty and predictability with respect to priority over cash collateral provided by Ontario-based market participants will significantly contribute to financial stability in the derivatives markets in which they take part, and will enhance their ability to compete in these markets on a more cost-efficient basis. It is, however, equally important in many other types of financial markets transactions, such as margin lending, securities loans and repurchase transactions. Many of our members participate in these types of transactions also and they may be cross-margined with derivatives products, including on clearing organizations.

You have identified that perfection of a security interest in cash collateral by registration does not provide the legal certainty that is needed for the secured party to have a first-priority claim in the collateral, thus creating legal risk. We agree that this is the primary issue. There is no legal assurance of priority in a registration regime. Priority depends on order of registration, which in turn can only be satisfied by conducting searches, reviewing what can be hundreds of prior registrations, and obtaining subordinations or waivers from any secured creditors whose registrations indicate an interest in the same class of collateral (i.e. accounts or other). The law (and not a difficult, costly and timely due diligence process) must provide for priority for this to be a widely acceptable class of collateral.<sup>1</sup> As we enter an era where collateral requirements will increase exponentially because of clearing requirements and new capital rules, the ability of market participants to efficiently provide and receive cash collateral will be even more important.

2. *In our view, does the OBA's proposed solution solve the issue outlined above?*

Yes. As you may be aware, ISDA wrote to the Ontario government on the important subject of cash collateral reform on June 28, 2009 and again on April 13, 2010,

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<sup>1</sup> The registration requirement in and of itself is not the impediment. Many market participants do perfect by registration. It is the fact that registration does not establish a first priority that is the issue.

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to encourage the government to consider amendments to Ontario law. (We have attached copies of our previous correspondence.) In June 2009, ISDA proposed a legislative solution which was similar in concept to the OBA Proposal. ISDA supports the OBA Proposal and believes that implementing it will create a more predictable and certain regime for obtaining a first priority security interest in cash collateral regardless of the form of security interest taken. A regime that confers a first priority based on control in a fashion similar to securities is a favourable solution. We strongly support that the solution proposed by the OBA is not restricted to particular types of secured transactions.

3. *Do we see any issues with the OBA's proposed solution? Would the proposal have any negative impacts upon our members or other parties?*

We believe that our members in the context of their derivatives and other financial markets business would significantly benefit from the OBA's proposed solution. We have not identified any negative impacts.

Our organization is not at this time providing specific comments on the drafting of the proposed legislative changes.

4. *How would we propose to solve any concerns identified? Would we suggest amending the PPSA (if so, how?), or some other solution?*

Not applicable.

5. *Do we have any suggestions as to what the timing of the solution should be?*

We would encourage the Ontario government to move quickly to implement this reform. Two particular developments are creating the need to take immediate steps.

First, as you will be aware, Canada and other countries committed in September 2009 at the G-20 meeting in Pittsburgh to require clearing with central counterparties of standardized OTC derivatives by the end of 2012. Many Canadian financial institutions already voluntarily clear certain types of OTC derivatives and soon many market participants will be required to clear certain types of OTC transactions, either by Canadian rules or by the rules to which they are subject in other jurisdictions, such as the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>2</sup>

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<sup>2</sup> The exact dates for U.S. implementation of mandatory clearing for certain swaps, such as interest rate, commodity and credit swaps (those for which clearing on multiple clearing organizations is currently available) is not known because they depend on final rules being published by the CFTC and the exercise of CFTC discretions with respect to timing of the phase-in of mandatory clearing. It is reasonably foreseeable that the CFTC could impose mandatory clearing of certain products as early as the fall of 2012 and that Canadian dealers could be subject to these requirements with respect to their business with U.S. counterparties and clients.

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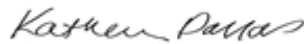
Second, new financial institution capital rules that will come into effect in January of 2013 will also impose very significant costs on OTC transactions that are either uncleared or not supported by fully enforceable collateral arrangements.

As these changes come into effect, there will be a significantly increased demand for collateral both from and by Canadian market participants. Clearing organizations are required to be fully collateralized for the credit exposure they accept under cleared transactions. As well, members of clearing organizations who clear trades on behalf of customers who are not members will require collateral from those customers. Market participants will not only prefer to post and receive cash collateral, but as a practical matter, given the anticipated level of the demand for collateral, will be required to meet their collateral requirements, at least in part, with cash collateral in order to fully participate in these markets. For operational reasons, cash collateral is also a preferred form of collateral as it can be transferred easily on a daily basis in amounts that precisely match the constantly changing credit exposure of the parties to each other.

Under current Ontario law, legal advisors are not in a position to provide a legal opinion that a collateral receiver has a first priority security interest in cash collateral. Without such opinions, cash collateral will either not be accepted from Canadian market participants or, if accepted, may be significantly discounted. This would have the result of either preventing Canadian market participants from participating in central clearing or imposing significantly increased costs upon Canadian market participants in connection with their participation. As we noted in both 2009 and 2010, Canadian market participants are already competitively disadvantaged by Ontario's current law. They will be even more disadvantaged as mandatory clearing regulations and the capital rules favouring clearing become effective. It is not only important that the Ontario government indicate its intention to move forward with reform, but that it actually implements reform, preferably in 2012. Given that many of Canada's financial institutions are based in Ontario, reforming Ontario law is of the utmost priority.

ISDA would be pleased to provide you with any further information that you believe would assist you in assessing the OBA Proposal and moving forward with this important initiative.

Yours truly,



Katherine Darras

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