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May 11, 2015

DELIVERED VIA ELECTRONIC MAIL
Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

c/o:
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c/o:
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Dear Sirs/Mesdames:

RE: Comment Letter to CSA Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the "Proposed Clearing Rule") and Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives* (the "Proposed Clearing CP")

Capital Power Corporation, together with its affiliates and subsidiaries (collectively, "**Capital Power**"), makes this submission to comment on the Proposed Clearing Rule and the Proposed Clearing CP, which will be collectively referred to in this letter as the "**Proposed National Instrument**". Capital Power appreciates the opportunity to comment and commends the Canadian Securities Administrators ("**CSA**") for seeking public input on the Proposed National Instrument.

Capital Power is a growth-oriented North America power producer headquartered in Edmonton, Alberta. Capital Power develops, acquires, operates and optimizes power generation from a variety of energy sources, including coal, natural gas, biomass and wind. Capital Power owns more than 2700 megawatts

of power generation capacity across 15 facilities in Canada and the United States, and owns 371 megawatts of capacity through power purchase arrangements. An additional 1020 megawatts of owned generation capacity is under construction or in advanced stages of development in Alberta and Ontario.

Capital Power optimizes and hedges its commodity portfolio using physical forward contracts for electricity, natural gas, environmental commodities (e.g. carbon offsets and credits), USD/CDN currency exchange, and financial derivative transactions based on those same commodities. Capital Power's trading counterparties include other power producers, utility companies, banks, hedge funds and other energy industry market participants. Trading activities take place primarily through electronic exchanges, such as ICE (Intercontinental Exchange) and NGX (Natural Gas Exchange), but also through brokered transactions and directly with counterparties. Capital Power is a registered "market participant" in the Alberta wholesale electricity market constituted as the Alberta "Power Pool" under the *Electric Utilities Act* of Alberta (the "**EUA**") and is also a licensed "retailer" (as defined in the EUA) of retail electricity services to large commercial and industrial customers in the retail electricity market in the Province of Alberta.

Capital Power generally supports the efforts of the CSA to establish a regulatory regime for the Canadian over-the-counter ("**OTC**") derivatives market, in order to address Canada's G-20 commitments. To that end, Capital Power respectfully urges the CSA to develop regulations that strike a balance between not unduly burdening derivatives market participants while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities. Capital Power is a member of the International Energy Credit Association ("**IECA**") and fully supports the comments submitted by the IECA in response to the Proposed National Instrument.

Capital Power thanks the CSA for considering, and making changes based on, public comments, including those of Capital Power, to CSA Notice 91-303 *Proposed Model Provincial Rule on Mandatory Counterparty Clearing of Derivatives* (the "**Draft Model Rule**"), which the CSA published on December 19, 2013, and which set the stage for the Proposed National Instrument. In particular, Capital Power commends the CSA for the following changes from the Draft Model Rule to the Proposed National Instrument: (i) opting to develop a national instrument, rather than province-specific model provincial rules, with respect to mandatory clearing of derivatives; (ii) removing the requirement to obtain board approval to qualify for the end-user exemption; (iii) allowing counterparties to rely on representations made to each other in determining whether clearing exemptions are available; (iv) the clarifications with respect to completing and filing proposed Form F1; and (v) the proposed phase-in approach with respect to the clearing requirement. Despite these and other positive changes however, Capital Power still has concerns about the provisions of the Proposed National Instrument and offers the specific comments below for the CSA's further consideration.

SPECIFIC COMMENTS:

Capital Power has the following specific substantive comments regarding the Proposed National Instrument:

1. **Definition of "financial entity"**

As Capital Power noted in its March 19, 2014 comment letter in response to the Draft Model Rule, and as is still the case in the Proposed National Instrument, the definition of a "*financial entity*", in section 1(e) of the Proposed National Instrument, includes persons or companies that are either (i) subject to a

registration requirement, (ii) registered, or (iii) exempt from the registration requirement, under securities legislation of a Canadian jurisdiction. In our March 2014 letter we asked the CSA to clarify the registration characteristics given that the CSA had not at that time (and still hasn't) finalized any rules with respect to derivatives market participant registration. Capital Power understands that other commenters to the Draft Model Rule raised similar concerns and we note the responses given by the CSA in its February 12, 2015 Notice and Request for Comment document (the "**Clearing Rule Notice**") that introduced the Proposed National Instrument.

At page 11 of the Clearing Rule Notice, and in response to comments about the registration issue, the CSA states that it believes that the proposed phase-in approach to the clearing requirement under the Proposed National Instrument will allow provincial regulators time to clarify the developing registration regime. Although Capital Power fully supports a phased-in approach to the clearing requirement and agrees that more clarity is required about the registration regime, Capital Power still strongly believes that the clearing requirement should not become effective at all until, or unless, the registration regime is finalized. Capital Power respectfully submits that making the clearing requirement effective before the registration regime is finalized represents the idiom of "putting the cart before the horse". If the registration regime is not finalized before the first clearing requirement becomes effective under the proposed phase-in approach, how would the CSA suggest that market participants determine their status as "financial entities" or not under the registration characteristic within that definition? Capital Power respectfully submits that such determination is impossible unless, or until, the registration requirements are finalized.

2. <u>Definition of "local counterparty"</u>

With respect to sub-paragraph (b) of the "local counterparty" definition in section 1 of the Proposed National Instrument, Capital Power requests that the CSA please clarify what it intends the words *"…is responsible for the liabilities of the counterparty;*" to mean? In particular, does the CSA intend those words to mean responsible for: (i) all of such affiliated entity's liabilities of any kind whatsoever; (ii) just liabilities with respect to derivatives trades; (iii) liabilities on a trade by trade, or counterparty by counterparty basis; or (iv) some other meaning?

3. <u>Interpretation of hedging or mitigating commercial risk</u>

Capital Power thanks the CSA for revising the interpretation of "hedging or mitigating commercial risk", found in section 4(1) of the Proposed National Instrument, from the definition that was found in the Draft Model Rule, in particular the deletion of the "closely correlated" and "highly effective" language that was vague and confusing. We also find the revised explanatory guidance on this point in the Proposed Clearing CP to be helpful. That said, Capital Power requests that the CSA please provide additional guidance with respect to the following issues that arise from the revised interpretation:

(a) The words "… establishes a position which is ***intended to*** reduce risk …" *[emphasis added]*, begs the question of how such intent is to be determined, demonstrated or documented? In Capital Power's experience, it is common, with respect to energy commodity derivatives at least, for derivatives market participants to segregate their derivatives into various "trading books", based on various criteria. Criteria could be factors such as commodity asset class, transaction time period (short-term v. long-term derivatives), or "hedges" versus "speculative" derivative transactions. Transactions are contemplated, entered into and then classified as, or allotted to, a particular trading book based on an overall derivatives trading strategy that is typically governed

by underlying corporate risk management and asset optimization policies and procedures. Those policies and procedures typically have been vetted and approved by senior executive and possibly also boards of directors.

Given the above described governance framework, would the CSA please confirm whether a derivatives market participant, that had such a governance framework in place, could simply rely on its derivatives trading book classification system for the purposes of determining, demonstrating and documenting the intent required by section 4(1) of the Proposed National Instrument? In other words, could such a market participant regard those of its derivatives allocated to its "hedging trade book", in accordance with its internal derivatives governance practices, as satisfying the intent requirement of section 4(1), provided that such derivatives also satisfied the other requirements set forth in subparagraphs 4(1)(a) & (b)? If the answer to the foregoing question is "no", then Capital Power respectfully requests that the CSA please clarify how else a party might determine, demonstrate and document the intent required by section 4(1)?

4. <u>"Speculate" should be defined or clarified</u>

Capital Power respectfully urges the CSA to either define, or further clarify, what it considers the term "speculate" (in paragraph 4(2)(2)) means for the purposes of the Proposed National Instrument? Because derivative positions held to "speculate" may not benefit from any of the exemptions to mandatory clearing contained in the Proposed National Instrument, Capital Power submits that "speculate" needs to be clearly defined so that market participants can properly comply with the clearing requirement. Capital Power suggests that a practical definition of "speculate" could be framed in terms of derivatives trading activity that does not have a direct or indirect nexus to hedging or mitigating commercial risks faced by the party engaged in such trading, but is solely entered into for purposes of potentially generating profit or of investing for potential gain.

5. <u>Crown Entity Exemption - Section 6</u>

Capital Power was extremely disappointed to see that the exemption from the clearing requirement that was made available to Crown corporations, or entities whose obligations are guaranteed by the federal or provincial governments, under section 11 of the Draft Model Rule, survived as section 6 of the Proposed National Instrument. As we stated in our March 19, 2014 comment letter to the Draft Model Rule, we strongly believe that this exemption would give such entities, to the extent they participate in derivatives markets, a significant competitive advantage over "non-Crown" entities that will be required to comply with the clearing mandate.

The clearing compliance requirement will undoubtedly result in additional costs compared to transacting derivatives over-the-counter. Non-Crown entities will have to incur these additional costs while Crown entities will avoid them, thereby giving Crown entities a competitive cost advantage. Based on Capital Power's market experience several Crown entities are active and sophisticated derivatives market participants and do not need competitive enhancements from the CSA's derivatives regulatory regime.

To better ensure transparency and a "level playing field" in derivatives markets Capital Power submits that all derivatives market participants should be subject to the same requirements with respect to mandatory clearing, or exemptions from it, and special treatment should not be afforded to one particular class of market participant to the potential detriment of other classes. Alternatively, if special treatment is to be

given to particular classes of derivatives market participants, that treatment should be based on objective criteria, such as credit rating metrics, market capitalization, derivatives portfolio size, etc., that are evenly applied to all market participants.

We note the CSA's comments in connection with this issue at pages 19-20 of the Clearing Rule Notice, namely that provincial regulators may at some point in the future modify the applicability of all exemptions, including the Crown entity clearing exemption. In response to those comments, Capital Power respectfully submits that (i) now is the time for the CSA to get these rules right, rather than deferring to potential future action by provincial regulators, and (ii) to the utmost extent possible the rules should be consistent across Canada, rather than a patch-work of different provincial rules. Leaving this issue to potentially be addressed and modified by provincial regulators at some future date appears to undermine the rationale for the Proposed National Instrument approach in the first place.

Another concern that Capital Power has with the language in section 6 is the potential availability of a clearing exemption to foreign governments and entities owned and controlled by foreign governments under sub-section 6(a). Capital Power respectfully submits that providing a clearing exemption, *ab initio* and without further qualifying criteria, to foreign governments and their commercial entities is entirely arbitrary, unreasonable and unjustifiable. The Committee appears to have assumed that just because a derivatives market participant is either a foreign government, or a commercial entity of a foreign government, that market participant's derivatives trading activities would pose no systemic risk to Canada's financial system.

Capital Power would respectfully point out to the Committee that many foreign governments, and by extension their commercial entities, have extremely poor credit ratings. In addition, they may have laws in place in their respective countries that restrict the enforcement of guarantees by foreign beneficiaries against companies owned by the respective home governments. As a result, participation by such foreign governments and their commercial entities in Canadian derivatives markets could indeed pose serious systemic risk to those markets. Capital Power strongly urges the Committee to reconsider and remove the non-application of the clearing requirement to foreign governments and their commercial entities unless such governments and entities can demonstrate that: (i) they satisfy certain objective and quantifiable financial metrics, such as credit ratings; and (ii) their Canadian derivatives trading activities do not in fact pose systemic risk within Canada.

6. End-User Exemption-Section 9

Capital Power respectfully submits that sub-paragraph 9(2)(c) of the Proposed National Instrument should be deleted in its entirety because it is illogical and unnecessary. The provisions in sub-paragraphs 9(2)(a) and (b) are adequate to ensure that the end-user clearing exemption is not abused.

In the context of a corporate family centralizing its derivatives trading activity through one affiliate (the "**Trading Agent**") that transacts on behalf of its other affiliates (the "**Trading Principal(s)**"), Capital Power does not understand why the status of the Trading Agent as a "registrant", or not, under Canadian securities law, should be relevant to determining whether an end-user clearing exemption is available, or not, with respect to derivative trades pertaining to the Trading Principals? It should be the Trading Principal's status as a registrant, or not, that determines whether a clearing exemption is available to it with respect to derivative transactions entered into either by it directly, or on its behalf by its Trading Agent.

That determination is adequately addressed in sub-paragraphs 9(2)(a) and (b) of the Proposed National Instrument and accordingly, the Trading Agent's registrant status should be irrelevant to the issue.

7. <u>Intragroup Exemption-Section 10</u>

Concerning sub-paragraph 10(2)(a), Capital Power asks that the CSA please clarify that the "agreement" between affiliated counterparties to rely on the intragroup clearing exemption, referred to in that sub-paragraph, need not be a written agreement on a transaction by transaction basis. Capital Power submits that requiring that level of agreement specificity would be both extremely onerous on market participants and do little to address systemic risk. Instead, Capital Power submits that the "agreement" requirement in sub-paragraph 10(2)(a) should be considered satisfied as long as the two affiliates have written documentation between them, for example, either an express agreement or joint policies and procedures, that address the circumstances under which they will rely on the intragroup clearing exemption for derivative trades between them that qualify for that exemption.

Concerning the requirement for *"… a written agreement setting out the terms of the transaction between the [affiliated] counterparties"* in sub-paragraph 10(2)(c), Capital Power asks that the CSA clarify that the requirement would be satisfied by there being one or more written master forms of agreements in place between the affiliated counterparties, under which they are enabled to enter into specific derivative transactions, but that there need not be written confirmations for each such specific transaction. Capital Power submits that requiring written confirmations on a trade by trade basis for affiliated counterparties whose financial statements are prepared on a consolidated basis is unnecessary, overly onerous and does not contribute to reducing systemic risk.

Capital Power respectfully requests that the CSA consider its comments and again expresses its gratitude for the opportunity to provide comments. If you have any questions, or if we may be of further assistance, please contact Mr. Zoltan Nagy-Kovacs, Senior Counsel, at 403-717-4622 (znagy-kovacs@capitalpower.com)

Yours Truly,

"***CAPITAL POWER***"

Per: *"Zoltan Nagy-Kovacs"*

Zoltan Nagy-Kovacs
Senior Counsel