CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment

Draft *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*

Draft *Policy Statement to Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*

January 21, 2016

I. Introduction

We, the Canadian Securities Administrators (the **CSA**) are publishing the following for a ninety (90) day comment period, expiring on April 19, 2016:

- Draft *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Positions and Collateral* (the **Regulation**);

- Draft *Policy Statement to Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Positions and Collateral* (the **Policy Statement**).

Collectively, the Regulation and the Policy Statement will be referred to as the **Proposed Regulation**.

We are issuing this notice to provide interim guidance and solicit comments on the Proposed Regulation.

We would also like to draw your attention to the recent publication of *Regulation 24-102 respecting Clearing Agency Requirements* and the upcoming publication of draft *Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives* and in particular the scope of application of mandatory clearing requirements. These publications, including the Proposed Regulation, relate to central counterparty clearing. We therefore encourage the public to consider these publications comprehensively.

II. Background

On January 16, 2014, the CSA OTC Derivatives Committee (the **Committee**) published CSA Notice 91-304 *Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Positions and Collateral* (the **Model Rule**). The Committee invited public comments on all aspects of the Model Rule. Twenty-two comment letters

were received. A list of those who submitted comments, as well as a chart summarizing the comments received and the Committee's responses are attached in Annex A to this Notice. Copies of the comment letters can be found on the CSA members' websites.[1]

The Committee has carefully reviewed the comments received and has made determinations on appropriate revisions to the Model Rule, which has been transformed into the Proposed Regulation for the purpose of adopting a harmonized instrument across Canada.

Following the expiry of the comment period, the Committee will review all comment letters received in respect of the Proposed Regulation to make recommendations on changes at a Committee level.

III. Substance and Purpose of the Proposed Regulation

Canadian and international initiatives promoting the clearing of over-the-counter (**OTC**) derivative transactions will cause certain market participants, who are not clearing members at a derivatives clearing agency, to clear their OTC derivatives transactions indirectly through market participants that are clearing members or otherwise provide clearing services. The purpose of the Regulation is to ensure that customer clearing is carried out in a manner that protects customer collateral and positions and improves derivatives clearing agencies' resilience to a clearing member default. For a more detailed explanation of customer clearing please see CSA Consultation Paper 91-404 *Derivatives: Segregation and Portability in OTC Derivatives Clearing*.[2]

The Regulation contains requirements for the treatment of customer collateral by clearing intermediaries and derivatives clearing agencies, including requirements relating to the segregation and use of customer collateral. These requirements are intended to ensure that customer collateral is protected, particularly in the case of financial difficulties of a clearing intermediary. The Regulation includes detailed record-keeping, reporting and disclosure requirements intended to ensure that customer collateral and positions are readily identifiable. The Regulation also contains requirements relating to the transfer or porting of customer collateral and positions intended to ensure that, in the event of default or insolvency of a clearing intermediary, customer collateral and positions can be transferred to one or more non-defaulting clearing intermediaries without having to liquidate and re-establish the positions.

IV. Summary of the Regulation

Part 1 of the Regulation sets out relevant definitions, and specifies that the Regulation applies only to trades in derivatives where a customer, regulated clearing agency member or clearing intermediary has a specified nexus to a local jurisdiction.

Part 2 to Part 4 of the Regulation set out requirements applicable to clearing

[1] Available at www.lautorite.qc.ca/en/previous-consultations-derivatives-pro.html.
[2] Available at www.lautorite.qc.ca/en/previous-consultations-derivatives-pro.html.

intermediaries with respect to treatment of customer collateral, record keeping and disclosure.

Part 2 of the Regulation sets out the manner in which customer margin and collateral is to be treated by clearing intermediaries. This Part sets out requirements in respect of the collection, holding and maintenance of customer collateral, the identification of excess margin as well as the segregation, use and investment of customer collateral. Part 2 also sets out requirements for a clearing intermediary to be able to provide clearing services to a customer, and for appropriate risk management in respect of those services.

Under Part 3 of the Regulation, clearing intermediaries are required to keep and retain certain records and supporting documentation, and keep adequate and appropriately updated books and records that will facilitate the identification and protection of customer positions and collateral.

Part 4 of the Regulation sets out disclosure requirements for clearing intermediaries as well as reports required to be submitted to the regulator or the securities regulatory authority.

Part 5 to Part 7 of the Regulation are parallel to Part 2 to Part 4 of the Regulation, and set out similar requirements as they apply to regulated clearing agencies.

Part 5 of the Regulation sets out how customer margin and collateral is to be treated by regulated clearing agencies. This Part sets out requirements in respect of the collection, holding and maintenance of customer collateral, the identification of excess margin as well as the segregation, use and investment of customer collateral.

Under Part 6 of the Regulation, regulated clearing agencies are required to keep certain records and supporting documentation as well as keep adequate and appropriately updated books and records that will facilitate the identification and protection of customer positions and collateral.

Part 7 of the Regulation sets out disclosure requirements for regulated clearing agencies as well as reports required to be submitted to the regulator or the securities regulatory authority.

Part 8 of the Regulation sets out the requirements for a regulated clearing agency to facilitate the transfer of customer positions and collateral in the context of a clearing intermediary's default, or at the request of a customer, under certain specified conditions. Part 8 also requires a clearing intermediary to have policies and procedures for transferring of customer positions and collateral, when the clearing intermediary provides clearing services to an indirect intermediary.

Under Part 9 of the Regulation, clearing intermediaries and regulated clearing agencies located in foreign jurisdictions may be exempted from compliance with the Regulation where they meet certain requirements set out in the Regulation, including by complying

with similar legislation in their home jurisdiction.

Part 10 of the Regulation contains provisions authorizing the regulator or the securities regulatory authority, as the case may be, to grant an exemption from any provision of the Regulation.

Part 11 of the Regulation sets out relevant effective dates for the Regulation.

V. Changes Reflected in the Proposed Regulation

(a) Fundamental Changes to Model Rule

Acceptable Clearing Models

There are various customer clearing models available in the global OTC derivatives market.[3] The Committee believes that it is important for local customers to have the option to use the model or models that are most suitable for their needs, provided that each model available provides adequate protection for customer positions and collateral. A fundamental comment received during the consultation process was that the Model Rule did not facilitate the operation of certain widely used customer clearing models.[4] In response, the Committee has made significant revisions to the Regulation that make a broader range of clearing models available to local customers. This revised approach has led to revisions throughout the Regulation.

Due to the variety of customer clearing models and legal frameworks supporting these models, the Regulation, as revised, potentially permits a wider range of clearing agencies to offer their customer clearing models in Canada. To enhance customer protection, the approval and oversight process for recognized or exempt clearing agencies will involve a thorough review of the customer safeguards provided by each clearing agency offering customer clearing in a jurisdiction of Canada.

Scope of Application of the Regulation

The Model Rule was drafted in a broad manner to apply where any participant in the customer clearing chain (i.e., the customer, a clearing intermediary and/or the clearing agency) was located in a jurisdiction of Canada. Comments were received that this application was overly broad. The Regulation has been revised to apply to a clearing intermediary or foreign clearing agency only where it is involved in a transaction with a local customer. The requirements applicable to regulated clearing agencies apply to any regulated clearing agency located in a jurisdiction of Canada for transactions with both local and foreign customers.

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[3] For example, the futures commission merchant model is available in the U.S. and the principal-to-principal model is available in the EU.

[4] In particular the comments received indicated that the Model Rule was not compatible with the principal-to-principal model.

(b) Other changes to the Model Rule

(i) Clearing Intermediaries

The Model Rule was designed such that only one clearing intermediary was permitted to be involved in a customer cleared transaction. The Committee acknowledges that this approach is not consistent with international market structures. Therefore, the Regulation has been revised to permit the involvement of multiple clearing intermediaries in a transaction. Each clearing intermediary involved in a transaction is therefore subject to the full requirements of the Regulation in order to ensure that no significant additional risk is introduced to the customer clearing chain.

(ii) Substituted Compliance

Currently, OTC derivative clearing infrastructure and service providers are largely concentrated outside of Canada. Therefore, it is likely that many local customers' cleared transactions will involve foreign infrastructure or market participants. As a result, the Committee has carefully considered the interaction of the Regulation with other foreign customer clearing regimes that may also impact a transaction involving local market participants or infrastructures. The Committee is proposing substituted compliance in specified circumstances where a foreign entity is involved in a transaction and appropriate foreign laws apply.

(c) Miscellaneous drafting clarifications

There are a number of non-substantive drafting changes, including a re-ordering of the Parts to separate requirements applicable to clearing intermediaries from those applicable to regulated clearing agencies.

VI. Application of local rules for Derivatives: Product Determination

The Committee intends that Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*,[5] Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*,[6] Québec *Regulation 91-506 respecting Derivatives Determination*[7] and the Multilateral Instrument 91-101 *Derivatives: Product Determination*[8] (collectively, the **Product Determination Rules**) will be applicable to the Regulation. Therefore, in all local jurisdictions, transactions that are cleared on behalf of a customer that fall within the scope of the applicable Product Determination Rules would be subject to the Regulation. We note that once the Proposed Regulation is in force, Regulation 91-506 respecting Derivatives Determination will be amended to apply

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[5] Available at https://www.osc.gov.on.ca/en/SecuritiesLaw_91-506.htm
[6] Available at http://docs.mbsecurities.ca/msc/irp/en/item/101711/index.doc
[7] Available at http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=3&file=/I_14_01/I14_01R0_1_A.HTM
[8] Available at http://www.albertasecurities.com, http://www.bcsc.bc.ca, http://www.nbsc-cvmnb.ca, http://nssc.novascotia.ca and http://www.fcaa.gov.sk.ca/Securities%20Division

to the Regulation. Accordingly, in Québec, *Regulation to amend Regulation 91-506 respecting Derivative Determination* is published by the *Autorité des marchés financiers* for consultation concurrently with the Proposed Regulation.

VII. Anticipated Costs and Benefits

The Proposed Regulation seeks to ensure that the Canadian market for clearing customer OTC derivatives develops in a safe and efficient manner. It proposes a robust investor protection regime for Canadian clearing customers equivalent to the protections offered in major international markets and should also provide systemic benefits to the Canadian market. There will be compliance costs for clearing service providers that may increase the cost of clearing for market participants. In the Committee's view, the benefits to the Canadian market of implementing the Proposed Regulation significantly outweigh the compliance costs to market participants. The major benefits and costs of the Proposed Regulation are described below.

(a) Benefits

The two major benefits of the Proposed Regulation are the reduction of systemic risk and the protection of customers and their assets when they indirectly clear OTC derivatives through clearing agencies.

(i) Mitigation of Systemic Risk

The G20 has agreed that requiring standardized and sufficiently liquid OTC derivatives transactions to be cleared through central counterparties will result in more effective management of counterparty credit risk. In addition, the clearing of derivatives may also contribute to greater stability of our financial markets and to a reduction in systemic risk. The Proposed Regulation is designed to create a framework for customer clearing that promotes stability of the OTC derivatives market by facilitating, to the greatest extent possible, the porting of customer positions and collateral. Portability of customer positions and related collateral is a key mechanism to ensure that in the event of a clearing intermediary default or insolvency, customer positions are not terminated and customer positions and collateral can be transferred to one or more non-defaulting clearing intermediaries without having to liquidate and re-establish a customer's positions. Portability can mitigate difficulties associated with stressed market conditions such as a market-wide reduction in liquidity and price dislocation, allow customers to maintain continuous clearing access and generally promotes efficient financial markets.

(ii) Customer Protection

The Proposed Regulation is aimed at significantly reducing the likelihood that customers will suffer major financial losses in the event of a clearing service provider's insolvency. In general, customer clearing offers risk mitigation benefits to customers. However, if a robust customer protection regime is not in effect, there can be risks in the indirect clearing process, particularly if a clearing intermediary becomes insolvent. The Proposed Regulation provides customer protections that should significantly reduce the likelihood

of a range of negative potential consequences, that could occur in the event of a clearing intermediary's insolvency, including:

- forced liquidation of positions;
- loss or inaccessibility of collateral;
- loss of hedge positions necessitating re-entry into the market at time of stress to re-establish positions; and
- market uncertainty.

The Proposed Regulation mitigates many of these risks to customers by establishing robust collateral and record keeping requirements. It requires customer positions to be fully collateralized at the regulated clearing agency and obligates the regulated clearing agency and clearing intermediaries to keep records that identify customers and their positions in order to facilitate porting.[9]

(b) Costs

Generally, any increased costs resulting from compliance with the Proposed Regulation stem from enhanced collateral protection, record keeping and reporting requirements for customer collateral and positions. Any costs associated with complying with the Proposed Regulation will be borne by clearing intermediaries and regulated clearing agencies and would likely be passed on to customers through higher initial margins and/or higher fees for transactions. There is also a possibility that clearing service providers may be dissuaded from entering or remaining in the Canadian market due to the costs of complying with the Proposed Regulation reducing Canadian customers' options for clearing service providers.

(i) Establishing Systems

Clearing intermediaries and regulated clearing agencies will incur up-front costs to develop record-keeping and account structure systems required to comply with the Proposed Regulation. However, once systems are established, the incremental cost of on-going compliance should be less significant.

(ii) Loss of Potential Revenue for Clearing Intermediaries and Clearing Agencies

The Regulation places restrictions on the use and investment of customer collateral held by clearing intermediaries and clearing agencies. Customer collateral may only be invested in liquid and low-risk instruments. The Regulation also requires a regulated

[9] The level of protection afforded by the Proposed Regulation is dependent on the Proposed Regulation's interaction with other foreign and domestic laws such as bankruptcy and insolvency laws and the *Payment Clearing and Settlement Act* (Canada) as well as provincial and territorial personal property security laws including as they apply to cash collateral.

clearing agency to collect initial margin from clearing intermediaries for each customer on a gross basis. Gross margin promotes more effective porting of positions which benefits customers. However, this requirement means that less customer collateral will be held at and available for use by clearing intermediaries.[10] These requirements limit the potential revenue that clearing intermediaries and clearing agencies may earn through the use and investment of their customer's collateral.

(iii) Market Access Issues

Currently, OTC derivative clearing infrastructure and service providers are largely concentrated outside of Canada with the main clearing agencies and clearing intermediaries located in the United States and the European Union. Given the small size of the Canadian market there is a risk that the costs of analysing and complying with the Proposed Regulation may result in some market participants choosing not to offer customer clearing in Canada which may limit Canadian customers' access to OTC derivative clearing services. However, as described above, the Committee is proposing substituted compliance for equivalently regulated foreign institutions and this could significantly reduce compliance costs associated with the Proposed Regulation.

(c) Conclusion

Protection of customer positions and collateral is the fundamental principle of the Regulation. It is the Committee's view that the impact of the Proposed Regulation, including anticipated compliance costs for market participants, is proportional to the benefits sought. The Regulation aims to provide a level of protection equal to that offered to customers in other jurisdictions. To achieve a balance of interests, the Proposed Regulation is designed to deliver a high level of protection to customers transacting in OTC derivatives and create a safer environment in the Canadian market for customers to clear OTC derivatives, all while allowing clearing service providers a flexible and competitive market to operate in.

VIII. Contents of Annexes

The following annex forms part of this CSA Notice:

- Annex A – Summary of Comments and List of Commenters.

IX. Comments

In addition to your comments on all aspects of the Regulation, the Committee also seeks specific feedback on the following question:

> Should clearing intermediaries be limited to clearing derivatives for local customers with regulated clearing agencies? Please explain what the impact of this limitation would be on your current clearing activities.

[10] Clearing intermediaries would still have access to any excess collateral provided by customers.

Please provide your comments in writing by **April 19, 2016**.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the *Autorité des marchés financiers* at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

Please address your comments to each of the following:

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 Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Please send your comments **only** to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

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Please refer your questions to any of:

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ANNEX A

Summary of comments on *Model Provincial Rule – Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*

1. Issue/Reference	2. Summary of Comments	3. Response
GENERAL COMMENTS		
Harmonization of rules	A number of commenters emphasized the importance of harmonizing the Canadian derivatives regime with international rules and standards.	The Committee agrees and is committed to implementing harmonized rules consistent with international standards. See also the substituted compliance section below.
	One commenter suggested that provincial rules should be consistent and implementation timelines should be coordinated to avoid regulatory arbitrage.	Change made. The Committee notes that it has now opted to develop a national instrument, given its intention that the substance of the Model Rule be the same across local jurisdictions and that market participants and derivative products receive the same treatment across Canada.
Amendments to personal property security and bankruptcy regimes	A number of commenters emphasized the importance of ensuring that personal property security and insolvency laws work with the Proposed Regulation in order for Canadian participants to remain competitive on a global level.	The Committee is seeking to implement requirements which protect customer collateral, to the extent possible, under existing Canadian federal and provincial legal frameworks. The Committee notes that federal bankruptcy and provincial personal property security legislation are regimes which fall outside of the jurisdiction of the provincial securities regulatory authorities.
Customer protection model	Two commenters explained that the Model Rule is not compatible with the principal to principal model for customer clearing used in the European Union. One commenter asked which customer protection regime is proposed to be implemented in Canada.	Multiple changes made. The Instrument now facilitates the offering of various models of customer clearing including the principal to principal model.

Type of collateral accepted by a Derivatives Clearing Agency	A number of commenters suggested that the Committee should ensure that clearing agencies accept various types of Canadian collateral and/or increase the maximum amounts of such collateral they accept.	No change. The Committee recognizes the importance of Canadian clearing intermediaries and customers having the ability to utilize a broad range of collateral when posting collateral with a regulated clearing agency. Subject to the requirements and guidance provided in *Regulation 24-102 respecting Clearing Agency Requirements* and its policy statement, it is the Committee's view that it should generally not prescribe the types of collateral a regulated clearing agency should accept, nor the limits it should place on that collateral. A request that a regulated clearing agency accept specific forms of collateral should be made by a clearing intermediary to the clearing agency, which would then go through its normal risk management process.
Substituted compliance	One commenter suggested that foreign-based recognized clearing agencies be permitted to comply by way of substituted compliance so as to avoid duplicative and onerous regulation.	The Committee will consider substituted compliance where a regulated clearing agency is subject to equivalent regulation. See Part V, subparagraph (b)(ii) of the Notice for a description of the Committee's substituted compliance proposal.
PART 1: DEFINITIONS		
s. 1 – "clearing intermediary"	Two commenters suggested that the definition of "clearing intermediary" be expanded to include a scenario where there are multiple clearing intermediaries in a chain. One commenter suggested that financial intermediaries should be permitted to post collateral and meet reporting requirements on behalf of credit unions	Change made. The Instrument permits more than one clearing intermediary to be involved in a customer transaction. The Instrument does not prohibit clearing intermediaries from posting collateral on behalf of and fulfilling reporting requirements for their customers.
s. 1 – "customer collateral"	One commenter explained that the obligation to segregate variation margin is not possible for clearing agencies under certain customer protection models once the amount has been paid out to the clearing intermediary.	No change. Variation margin provided by a customer to its clearing intermediary is customer collateral and required to be segregated.

s. 1 – "excess margin"	One commenter suggested that the definition of "excess margin" be revised (i) to reflect that collateral is not excess margin until it is delivered to a clearing intermediary or clearing agency, and (ii) to clarify that any collateral delivered by a customer to a clearing agency or clearing intermediary which will be transformed should not be considered excess margin (i.e., it is the transformed collateral that is to be considered excess margin).	Change made. The definition has been revised to indicate that excess margin is customer collateral that has been delivered to a regulated clearing agency or clearing intermediary. Additionally, the CP has been revised to provide guidance clarifying that customer collateral initially delivered may be transformed and once transformed, only the transformed collateral is considered customer collateral and therefore excess margin.
	One commenter suggested that the definition be clarified to ensure that only collateral provided as margin for the customer's derivatives is included in the definition. Specifically, the commenter was concerned that confusion would arise where a customer provided a security interest in various collateral in accordance with standard customer account documentation (e.g., a security interest in all securities accounts or a security interest in all present and after-acquired property) that was not being used as margin for its derivative transactions. Another commenter suggested that the definition should be expanded to include collateral that is delivered by a customer in excess of the amount required by a clearing agency for operational efficiencies.	Change made. The definition has been revised to specify that excess margin is collateral in respect of a customer's cleared derivatives that is in excess of the amount of margin required by the regulated clearing agency to clear and settle such derivatives.
s. 1 – "permitted depository"	Two commenters suggested expanding the definition of "permitted depository" to include all entities through which collateral is currently being held by clearing agencies with global operations. Specifically, one commenter suggested expanding the definition to include securities settlement systems. The other commenter suggested that the definition should be broad enough to cover all potential securities intermediaries within an indirect holding system.	Change made. The definition in the Instrument covers various types of entities that are subject to a minimum amount of oversight required to ensure safekeeping of customer collateral including clearing intermediaries in the customer clearing chain that receive customer collateral. Other entities not covered by the definition may be granted an exemption on a case-by-case basis.
s. 1 – "permitted investment"	Two commenters suggested that minimum ratings (e.g., S&P, DBRS, Moody's) should be added as a requirement for an investment to be permitted and that the corresponding ratings be noted with the records of investment of customer collateral required under s. 23 of the Model Rule.	No change. The Committee has taken a principles based approach to permitted investments that does not rely on prescriptive requirements such as ratings.

PART 2: TREATMENT OF CUSTOMER COLLATERAL		
s. 2 – Collection of initial margin		
General Comments	Two commenters suggested that Canadian market participants should be given the choice to have initial margin requirements calculated in Canadian dollars.	No change. It is the Committee's view that it is not appropriate to include a requirement that could introduce foreign exchange risk. If collateral is only calculated, but not accepted in Canadian dollars, this would not be a useful service because the calculation would not represent the currency required to be delivered.
s. 2(1)	One commenter suggested amending the Model Rule so that initial margin can be collected by either gross or net methods. Another commenter also requested the Model Rule be amended to permit netting of collateral requirements.	No change. There is a greater likelihood that customer positions may be under-margined when collected on a net-basis. However, the Committee has amended the Model Rule to allow excess margin to be used to secure or extend credit to a customer.
s. 2(2)	One commenter suggested that it is not necessary to include a requirement for a clearing intermediary to collect initial margin given that s. 6 of the Model Rule obligates a clearing intermediary to keep sufficient property with a clearing agency.	Change made. The section has been removed from the Instrument.
	One commenter suggested that it be clarified whether a clearing intermediary may use its own property to fund initial margin requirements set by a clearing agency.	No change. There is no prohibition in the Instrument against a clearing intermediary using its own property; however, any property provided must be treated as customer collateral.
s. 3 – Segregation of customer collateral		
s. 3(2)	Two commenters suggested that the Model Rule should allow the option for customers to request that customer collateral be held using the Full Physical Segregation Model.	No change. The Committee is of the view that the Full Physical Segregation Model may be more costly than its alternatives and may not materially improve the degree of protection for customers of a clearing intermediary and therefore, there is no requirement that a clearing agency offer the Full Physical Segregation model. However, a customer may privately contract with a clearing intermediary or regulated clearing agency for Full Physical Segregation.

s. 3(3)	Two commenters requested that the Model Rule not prohibit portfolio margining, and also requested that a mechanism for allowing portfolio margining be included.	No change. The Committee will continue to monitor developments in the market, and may make changes to the Proposed Regulation, as necessary.
s. 4 – Holding of customer collateral		
General Comments	One commenter pointed out that Part 2 of the Model Rule permits commingling of customer collateral from multiple customers by clearing agencies and clearing intermediaries and that this seemed to contradict the requirement for individually segregated accounts to be held at a permitted depository. Additionally, two commenters suggested that the Model Rule should permit commingling of customer collateral.	Change made. Additional guidance has been added to the CP clarifying that customer collateral of multiple customers may be commingled in an omnibus customer account. The Instrument requires that the clearing intermediaries and clearing agencies identify the positions and collateral held for each individual customer within an omnibus customer account. Where a clearing intermediary or clearing agency deposits customer collateral with a permitted depository, the clearing intermediary or clearing agency is responsible for ensuring the permitted depository maintains appropriate books and records to ensure customer collateral can be attributed to each customer.
s. 4(3)	One commenter expressed concern regarding the requirement that all customer collateral be held in a segregated account that clearly identifies the name of each customer or otherwise indicates that the property in the account is customer collateral. The commenter's concern was that this may jeopardize the absolute transfer characterization of cash in such circumstances.	Change made. The Instrument does not require that the name of each customer whose customer collateral is held at a permitted depository be identified on the account, provided that the account is identified as holding customer collateral.
s. 6 – Clearing member maintenance of customer account balance		
s. 6	Three commenters suggested clarifying that clearing agency margin calls are to take place once each day, and that clearing intermediaries will not be required to cure any customer collateral shortfall on a continuous basis.	No change. The clearing intermediary will be required to meet the margin requirements of the clearing agency within the time limits set out by the clearing agency.

s. 8 – Use of customer collateral		
s. 8	One commenter expressed the view that market participants should have the right to contract in respect of excess collateral as they deem appropriate without restriction, and thus that the Model Rule should expressly allow the re-hypothecation of excess margin to the extent it is held by a clearing agency or clearing intermediary.	Change made. The Instrument has been revised to articulate that customer collateral may be bought or sold pursuant to an agreement for resale or repurchase under prescribed conditions.
	One commenter suggested that the Model Rule should expressly allow a clearing intermediary or a clearing agency to offer collateral transformation services to the customer.	Change made. The CP explains that collateral transformation is acceptable and transformed collateral would be considered customer collateral.
	One commenter noted that the CFTC's rules expressly provide for the right to withdraw customer collateral from a customer account to margin, guarantee, secure, transfer, adjust or settle the customer's cleared transactions and requested that the Model Rule make this point distinctly.	Change made. The language in the Instrument expressly grants this right.
	One commenter noted that margin held at the clearing intermediary level should be permitted to secure other obligations of the customer to the clearing intermediary.	Change made. Excess margin held by a clearing intermediary may be used to secure or extend credit to the customer.
s. 9 – Investment of customer collateral		
s. 9(1)	One commenter suggested that customers should be permitted to restrict how customer collateral is invested.	No change. The Instrument restricts investment of customer collateral to conservative investments (determined using a principles-based approach) and it is the Committee's view that further restrictions should be a private contractual matter between customers and clearing intermediaries or clearing agencies.
	One commenter suggested that a requirement to report all losses and gains made on investments of customer collateral be added to the Model Rule.	No change. Section 26 of the Instrument requires that the customer receive a daily report setting out the current value of customer collateral. This report includes any daily changes in the value of invested customer collateral.

s. 9(2)	One commenter expressed concern that a clearing intermediary may be liable for the losses that result from collateral that is transformed for the customer.	Change made. The CP clarifies that investment losses relate only to investments made by a regulated clearing agency or clearing intermediary using customer collateral, not to the collateral that is transformed for a customer.
	One commenter suggested that the Model Rule allow any investment losses incurred by a clearing agency to be mutualised and allocated to clearing intermediaries.	Change made. The CP explains that investment losses incurred by a regulated clearing agency may be mutualised and allocated to clearing intermediaries, but not to customers.
s. 10 – Acting as a clearing intermediary		
s. 10	One commenter suggested that a clearing agency should not be required to approve the clearing intermediary's customers. Instead, a clearing agency should be allowed to request information about customers and to refuse access to clearing services to a customer of a clearing intermediary.	Change made. A regulated clearing agency is no longer required to approve indirect intermediaries and customers.
s. 13 – Same		
s. 13	Two commenters requested clarification on what is meant by "prudentially regulated" and "appropriate regulatory authority".	Change made. The CP clarifies that, in Canada, prudential regulation of federally regulated financial institutions is undertaken by the Office of the Superintendent of Financial Institutions. Other regulators that perform prudential oversight include the Investment Industry Regulatory Organization of Canada and certain provincial prudential market regulators, such as the Autorité des marchés financiers in Québec or other local securities regulatory authorities. An appropriate foreign regulatory authority would be one that applies comparable regulatory standards to those applied to Canadian entities.

PART 3: RECORD-KEEPING		
s.16 – Retention of records		
s.16	One commenter requested that this requirement not apply to clearing agencies that are exempt from recognition under s. 147 of the *Securities Act* (Ontario).	No change. Retention of records is a requirement for all regulated clearing agencies and clearing intermediaries falling within the scope of the Instrument. However, substituted compliance may be available. See the substituted compliance section above.
s. 17 – Books and records		
s. 17(4)	One commenter suggested removing the word "market" from "market value" to provide for a wider range of alternatives when calculating customer collateral held.	Change made. The word "market" has been removed to ensure that other accepted types of valuation methodologies can be utilized, where appropriate.
s. 20 – Separate records – derivatives clearing agency		
s. 20	One commenter suggested that the Model Rule should require clearing agencies to keep records of the positions and property of each customer only where the customer is a direct customer of a clearing intermediary, and therefore, identifiable to the clearing agency. The commenter also suggested that the Model Rule should allow clearing agencies to keep records of the positions and property of each clearing intermediary's customers at an aggregate level per clearing intermediary.	No change. Without records for customers clearing through clearing intermediaries, portability would be impeded.
PART 4: REPORTING AND DISCLOSURE		
General Comments	Two commenters expressed concern over confidentiality and public access to the customer collateral reports.	Reports will be treated as confidential by securities regulatory authorities, subject to applicable provisions of the freedom of information and protection of privacy legislation adopted by each province and territory. However, the Committee may share the reports with self-regulatory organizations or other relevant regulatory authorities.

s. 25 – Disclosure to clearing members and customers		
s. 25(4)	Two commenters expressed concern over the requirement to receive written acknowledgements from customers and one of the commenters suggested to either make the disclosure publicly available or incorporate the disclosure into the legal agreements between the parties.	Change made. The requirement to receive written acknowledgements from customers has been removed.
s. 28 – Customer collateral report		
s. 28(3) and s. 28(4)	One commenter requested that this requirement not apply to clearing agencies that are exempt from recognition under s. 147 of the *Securities Act* (Ontario). Another commenter suggested that the requirements under these subsections should not apply to foreign-based recognized clearing agencies and instead they should be permitted to comply by way of substituted compliance.	No change. See the substituted compliance section above. The Committee would consider foreign reporting requirements in our substituted compliance analysis. However, the information contained in the reports is necessary in order for the securities regulatory authorities to fulfill their mandates.
s. 28(5)	One commenter requested clarification on whether the reporting requirement applies in respect of (a) each individual derivatives transaction or an aggregate net exposure for all derivatives transactions for a customer, and (b) each individual type of customer collateral or collateral on an aggregate basis, regardless of collateral type. The commenter also suggested that the Model Rule should be revised to include asset type and quantity (in addition to the market value) of customer collateral that is posted by a clearing intermediary to a clearing agency on behalf of a customer.	Change made. The reporting requirement is intended to be applied in respect of aggregate net exposures for all derivatives transactions of each customer. The Instrument requires clearing intermediaries to report the current value, asset type and quantity of the collateral received.
s. 29 – Disclosure of customer collateral investment		
s. 29(1)	One commenter expressed concern over inadvertently requiring a clearing agency to publicly disclose proprietary information such as its investment guidelines and policies.	Change made. Regulated clearing agencies are only required to disclose their investment guidelines and policies directly to the customer and, if applicable, a direct intermediary.
s. 29(2)	One commenter expressed concern over the onerous requirement to receive written acknowledgements from customers and suggested that disclosure be incorporated into the legal agreements between the parties.	Change made. See response to comments on s. 25(4).

s. 29(3)	Two commenters noted that the timing for submitting the required report is not specified.	Change made. Monthly reporting to securities regulatory authorities on customer collateral is required to be delivered within 10 business days of the end of each calendar month.
PART 5: TRANSFER OF POSITIONS		
General Comments	One commenter noted that a clearing agency may not be in a position to ascertain whether or not a customer is in default and suggested that the provisions of this section be revised to reflect the solvency status of the customer's account (i.e., whether or not the collateral value is sufficient to cover the initial margin obligations).	Change made. The Instrument now provides that a regulated clearing agency and a direct intermediary may facilitate porting of a customer's positions and collateral only where the customer's account is not currently in default.
s. 30 - Transfer of customer collateral and positions		
s. 30(1)	One commenter suggested changing the language of the subsection from "transfer of the customer's positions and customer collateral" to "transfer of the customer's positions and customer collateral or its liquidation proceeds".	Change made. The Instrument now permits transfer of the liquidation proceeds of customer collateral.
	One commenter requested clarification on when a clearing intermediary that is to receive transferred customer positions and collateral, or its liquidation proceeds, provides its consent to the transfer (i.e., if consent would be provided pursuant to arrangements made between parties at the outset of the relationship or concurrently with an event of default).	Change made. Additional guidance has been provided in the CP setting out that it is the Committee's view that such consent for transfer should be obtained at the outset of the clearing relationship.
s. 30(3)	One commenter suggested adding a requirement that conditions (a) to (e) be met within a reasonable time that is to be predetermined by a clearing agency.	No change; however, the Committee has provided additional guidance in the CP with respect to the timing for customers and direct intermediaries to provide consent to a transfer.

List of Commenters:

1. Atlantic Central
2. Caisse de dépôt et placement du Québec
3. Canadian Investor Protection Fund
4. Canadian Life and Health Insurance Association Inc.
5. Canadian Market Infrastructure Committee
6. Capital Power Corporation
7. Central 1 Credit Union
8. Concentra Financial Services
9. Enbridge Inc.
10. ICE Clear Credit LLC
11. IGM Financial Inc.
12. International Swaps and Derivatives Association, Inc.
13. Investment Industry Association of Canada
14. LCH.Clearnet Group Limited
15. NB Investment Management Corp.
16. Pension Investment Association of Canada
17. RBC Global Asset Management Inc.
18. SaskEnergy Incorporated
19. Suncor Energy
20. The Canadian Commercial Energy Working Group
21. TMX Group Limited
22. TransCanada Corp.