POLICY STATEMENT TO REGULATION 94-102 RESPECTING DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER COLLATERAL AND POSITIONS

PART 1
GENERAL COMMENTS

Introduction

This Policy Statement sets out the views of the Canadian Securities Administrators (the "CSA" or "we") on various matters relating to *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (the "Regulation") and related securities legislation.

Other than this Part, the numbering of Parts, sections, subsections, paragraphs and subparagraphs in this Policy Statement generally corresponds to the numbering in the Regulation. Any general guidance for a Part appears immediately after the Part's name. Any specific guidance on a section, subsection, paragraph or subparagraph in the Regulation follows any general guidance. If there is no guidance for a Part, section, subsection paragraph or subparagraph, the numbering in this Policy Statement will skip to the next provision that does have guidance.

Unless otherwise stated, any reference to a Part, section, subsection, paragraph, subparagraph or definition in this Policy Statement is a reference to the corresponding Part, section, subsection, paragraph, subparagraph or definition in the Regulation.

Definitions and interpretation

Unless defined in the Regulation, terms used in the Regulation and in this Policy Statement have the meaning given to them in securities legislation including *Regulation 14-101 respecting Definitions* (chapter V-1.1, r. 3).

Interpretation of terms used in the Regulation and in this Policy Statement

A number of key terms are used in the Regulation and this Policy Statement, including the terms that follow.

- "Clearing services" refers to acts in furtherance of the clearing of a customer's derivatives. This includes, among other things: submitting the customer's derivatives and associated collateral to a regulated clearing agency for clearing; monitoring and maintaining collateral requirements from the regulated clearing agency on behalf of a customer, including those for initial and variation margin; monitoring and maintaining excess collateral; recording and monitoring cleared positions, collateral received and valuations of both; and monitoring credit and liquidity limits.

Clearing services also include services provided from one clearing intermediary to another in furtherance of clearing a customer's derivatives. For example, a direct intermediary would be providing clearing services to an indirect intermediary where it accepts a customer's derivatives that were originally submitted by a customer to the indirect intermediary and submits it to a regulated clearing agency.

- "Global Legal Entity Identifier System" means the system for unique identification of parties to financial transactions developed by the Legal Entity Identifier Regulatory Oversight Committee.

- "Legal Entity Identifier Regulatory Oversight Committee" means the international working group established by the finance ministers and the central bank governors of the Group of Twenty nations and the Financial Stability Board, under the Charter of the Regulatory Oversight Committee for the Global Legal Entity Identifier System dated November 5, 2012.

- The term "lien" refers to a creditor's claim against property to secure repayment of a debt.

- "PFMI Report" means the April 2012 final report entitled *Principles for financial market infrastructures* published by the Bank for International Settlements' Committee on Payments and Market Infrastructure (formerly the Committee on Payment and Settlement Systems) and the Technical Committee of the International Organization of Securities Commissions, as amended from time to time.

Interpretation of terms defined in the Regulation

Section 1 – Definition of cleared derivative

A "cleared derivative" is submitted to and cleared by a clearing agency, either voluntarily or in accordance with the clearing requirement set out in *Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives* (*indicate here the reference*). The terms "directly" and "indirectly" refer to the chain of clearing intermediaries involved in a clearing a derivative. Where a customer interacts directly with a direct intermediary, the derivative would be considered to be directly submitted to and cleared by a clearing agency. Where an indirect intermediary submits a derivative to a direct intermediary for clearing on behalf of a customer, the derivative is considered to be cleared through the direct intermediary and indirectly submitted to the clearing agency.

Section 1 – Definition of customer

A direct intermediary is not a customer where it transacts with a clearing agency of which it is a participant. However, a person that acts as a direct intermediary can be a customer when clearing its own proprietary financial instruments through another direct intermediary of a clearing agency (or in Québec, a clearing house) where it is not itself a participant. An indirect intermediary is considered a clearing intermediary rather than a customer for a transaction in a cleared derivative where it is providing clearing services to a customer. However, a person acting as an indirect intermediary can be a customer to the extent that it is clearing its own proprietary financial instruments through another clearing intermediary. For certainty, there is always one and only one customer per clearing chain. The customer is the person entering into the derivative on its own behalf and accessing clearing services through one or more clearing intermediaries.

In a clearing chain that involves an indirect intermediary providing clearing services to a person, that person would be considered a customer of each clearing intermediary in the chain as well as of the clearing agency. For example, where a customer submits a derivative to an indirect intermediary, it would be a customer of both the indirect intermediary and the direct intermediary that submits the derivative to the clearing agency, as well as of the clearing agency. If there were multiple indirect intermediaries involved in clearing a derivative, the person would be considered a customer of each of these clearing intermediaries.

Section 1 – Definition of clearing intermediary

We expect that, subject to any available exemption, a clearing intermediary offering clearing services to a customer must register as a derivatives dealer when such requirement is in place. CSA Consultation Paper 91-407 *Derivatives: Registration* ("Consultation Paper 91-407") outlines the recommended business trigger for determining whether a person is in the business of trading derivatives.[1] These factors include intermediating transactions in derivatives and providing clearing services to third-parties. Please refer to Consultation Paper 91-407 for further details.

A person providing services in respect of a cleared derivative would be considered a clearing intermediary for the purposes of the Regulation if it requires, receives or holds collateral from, for or on behalf of a customer. Accordingly, an intermediary that does not receive, hold or transfer collateral from, for on behalf of a customer would not be subject to the requirements under the Regulation even if it facilitates some limited aspects of the relationship between a clearing intermediary and a customer with respect to cleared derivatives (e.g., organizing orders for derivatives).

[1] See subsection 6.1(b) of Consultation Paper 91-407.

Section 1 – Definition of customer collateral

With respect to "customer collateral", we wish to point out that although a customer may deliver certain collateral to a clearing intermediary, this specific collateral may not be the collateral delivered to the regulated clearing agency to satisfy the customer's margin requirements at the regulated clearing agency. A clearing intermediary may "upgrade" or "transform" the collateral delivered by the customer pursuant to their agreement. For example, a customer may deliver cash as collateral and, pursuant to their agreement, the clearing intermediary may deliver securities of an equivalent value to the regulated clearing agency. Any collateral that is transformed, upgraded or otherwise and delivered to the regulated clearing agency on behalf of a customer would be considered customer collateral. Generally, the original collateral delivered by the customer is no longer considered customer collateral once it has been transformed or upgraded and therefore is no longer subject to the requirements of the Regulation. The transformed or upgraded collateral exchanged for the customer's original collateral becomes the customer collateral that is subject to the Regulation and must be treated as customer collateral regardless of the number or type of transformations or upgrades it undergoes.

Paragraph (b) of the definition of "customer collateral" refers to a situation where a clearing intermediary submits its own property to satisfy the obligations of one or more customers to the regulated clearing agency. An example of this would be a direct intermediary providing its own property to meet an intra-day margin call by the regulated clearing agency. Where a clearing intermediary submits its own property on behalf of a customer, this property must be treated as customer collateral.

Section 1 – Definition of direct intermediary

A "direct intermediary" is a participant of the regulated clearing agency where a customer's derivative is submitted for clearing. A direct intermediary is responsible for submitting a customer's derivative to the regulated clearing agency and has obligations to the regulated clearing agency with respect to the derivative.

Section 1 – Definition of indirect intermediary

An "indirect intermediary" is a person that facilitates clearing on behalf of a customer but is not a participant of the regulated clearing agency where a customer's derivative is submitted. In order to clear its customer's derivative, the indirect intermediary would enter into an agreement with a direct intermediary (or another indirect intermediary that would in turn submit the derivative to a direct intermediary) that would submit the derivative to the regulated clearing agency to be cleared. This clearing relationship is often referred to as "indirect customer clearing".

It is possible that a person that is a direct intermediary at one regulated clearing agency could also act as an indirect intermediary in order to access another regulated clearing agency, of which it is not a participant. The classification as a direct intermediary or indirect intermediary is not exclusive. A clearing intermediary can be a direct intermediary for some derivatives and an indirect intermediary for others.

Section 1 – Definition of initial margin

The term "initial margin" refers to collateral required by a regulated clearing agency to cover potential future losses resulting from expected changes in the value of a cleared derivative over a pre-determined close-out period with a certain level of confidence.

Section 1 – Definition of participant

The term "participant" refers to a clearing intermediary that is a member of a regulated clearing agency.

Section 1 – Definition of permitted depository

A "permitted depository" is a person acceptable for holding customer collateral posted with a clearing intermediary or regulated clearing agency. A clearing intermediary that itself meets the requirements of the definition may hold customer collateral directly and is not required to use a third-party permitted depository.

In recognition of the international nature of the derivatives market, paragraph (e) of the definition permits a foreign bank or trust company with a minimum amount of reported shareholders' equity to act as a permitted depository and hold customer collateral, provided its head office or principal place of business is located in a permitted jurisdiction and it is regulated as a bank or trust company in the permitted jurisdiction. Paragraph (g) of the definition permits a prudentially regulated entity, other than a bank or trust company, whose head office or principal place of business is located outside of Canada, to act as a permitted depository for customer collateral it receives in connection with providing clearing services to a customer, provided that it is subject to and in compliance with the laws of a permitted jurisdiction relating to clearing services and customer collateral.

Section 1 – Definition of permitted investment

The term "permitted investment" sets out a principles-based approach to determining the types of instruments in which a clearing intermediary or regulated clearing agency may invest customer collateral, in accordance with the provisions of the Regulation. The term is intended to cover an investment in an instrument that is secured by, or is a claim on, high-quality obligors, and which allows for quick liquidation with little, if any, adverse price effect, for the purpose of mitigating market, credit and liquidity risk.

We expect that a clearing intermediary or regulated clearing agency that invests customer collateral in accordance with the Regulation would ensure such investment is:

- consistent with its overall risk-management strategy,
- fully disclosed to its customers,
- limited to instruments that are secured by, or are claims on, high-quality obligors, and
- able to be liquidated quickly with little, if any, adverse price effect.

We are also of the view that it would be inconsistent with the principles-based approach to permitted investments for a clearing intermediary or regulated clearing agency to invest customer collateral in its own securities or those of its affiliated entities.

Examples of instruments that would be considered permitted investments by the local securities regulatory authority include each of the following:

- debt securities issued by or guaranteed by the Government of Canada or the government of a province or territory of Canada;
- debt securities that are issued or guaranteed by a municipal corporation in Canada;
- certificates of deposit, that are not securities, issued by a bank listed in Schedule I, II or III to the *Bank Act* (Canada) ("Bank Act");[2]
- commercial paper fully guaranteed as to principal and interest by the Government of Canada;
- interests in money market mutual funds.

We are also of the view that foreign investments in high-quality obligors exhibiting the same conservative characteristics as the instruments listed above would be acceptable.

Section 1 – Definition of permitted jurisdiction

Paragraph (a) of the definition of "permitted jurisdiction" captures jurisdictions where foreign banks authorized under the Bank Act to carry on business in Canada, subject to

[2] *Bank Act* (SC 1991, c 46).

supervision by the Office of the Superintendent of Financial Institutions ("OSFI"), are located.[3] The following countries and their political subdivisions are included: Belgium, France, Germany, Ireland, Japan, Netherlands, Singapore, Switzerland, United Kingdom (including Scotland) and the United States of America.

For paragraph (b) of the definition of "permitted jurisdiction," in the case of the euro, where the currency does not have a single "country of origin", the provision will be read to include all countries in the euro area[4] and countries using the euro under a monetary agreement with the European Union.[5]

Section 1 – Definition of qualifying central counterparty

The definition of "qualifying central counterparty" is based on the qualifying central counterparty standard set out in the July 2012 final report entitled *Capital requirements for bank exposures to central counterparties*[6] published by the Basel Committee on Banking Supervision ("BCBS"). The BCBS has further stated[7] that if a regulator of a central counterparty has provided a public statement that the central counterparty has the status of a qualifying central counterparty, then the central counterparty may be considered to be a qualifying central counterparty. We are similarly of the view that a local counterparty may rely on a public statement made by a regulator of a central counterparty that the central counterparty is a qualifying central counterparty. The qualifying central counterparty standard is also discussed in CSA Multilateral Staff Notice 24-311 *Qualifying Central Counterparties*.

Section 1 – Definition of segregate

While the term "segregate" means to separately hold or separately account for customer collateral or positions, consistent with the PFMI Report, accounting segregation is acceptable.

Section 2 – Application

The Regulation applies to all regulated clearing agencies regardless of location; however, under subsection 2(1), a regulated clearing agency whose head office or principal place of business is in a foreign jurisdiction is only required to comply with the provisions of the Regulation with respect to the cleared derivatives of local customers. The Regulation has broader application with respect to a regulated clearing agency located in a local jurisdiction; such a regulated clearing agency is subject to the requirements of the Regulation in respect of the cleared derivatives of all of its customers (whether they are local customers or not).

The Regulation applies, regardless of location, to a clearing intermediary that provides clearing services to a local customer, but only in respect of a local customer's cleared derivatives. For example, a clearing intermediary providing clearing services to a local customer would be subject to the requirements of the Regulation only as they relate to the local customer and the cleared derivatives of the local customer. The Regulation is not applicable to the clearing intermediary when providing clearing services to foreign customers.

Under subsection 2(3), regulated clearing agencies and clearing intermediaries that provide clearing services for over-the-counter ("OTC") options on securities, are not required to comply with the Regulation in respect of such OTC options. Options on securities, including OTC options on securities, are subject to existing securities legislation. For example, OTC options on securities are regulated as securities under the *Securities Act* (Ontario) and as derivatives under the *Derivatives Act* (Québec).[8]

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[3] *Ibid.* at Part XII.1; For a list of authorized foreign banks regulated under the *Bank Act* and subject to OSFI supervision, see: Office of the Superintended of Financial Institutions, *Who We Regulate* (available: http://www.osfi-bsif.gc.ca/Eng/wt-ow/Pages/wwr-er.aspx?sc=1&gc=1#WWRLink11).

[4] European Union, Economic and Financial Affairs, *What is the euro area?*, May 18, 2015, online: European Union (http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm).

[5] European Union, Economic and Financial Affairs, *The euro outside the euro area*, April 9, 2014, online: European Union (http://ec.europa.eu/economy_finance/euro/world/outside_euro_area/index_en.htm).

[6] Basel Committee on Banking Supervision (BCBS), *Capital requirements for bank exposures to central counterparties*, July 2012, online: Bank for International Settlements (http://www.bis.org).

[7] BCBS, Basel III counterparty credit risk and exposures to central counterparties – Frequently asked questions, updated December 2012, online: Bank for International Settlements (http://www.bis.org).

[8] *Securities Act* (RSO 1990 c S.5) at s. 1(1), definition of "security"; *Derivatives Act* (CQLR 2008 c I-14.01) at s. 3, definition of "derivative".

PART 2
TREATMENT OF CUSTOMER COLLATERAL BY A CLEARING INTERMEDIARY

Part 2 contains requirements for the treatment of customer collateral by a clearing intermediary.

Section 3 – Segregation of customer collateral – clearing intermediary

Recognizing that methods for segregating customer collateral at the clearing intermediary level may differ depending on collateral and entity type, we are of the view that parties should have the benefit of flexibility in their collateral arrangements. However, the principle remains that notwithstanding the legal arrangement under which customer collateral is posted with a clearing intermediary, the clearing intermediary must treat customer collateral posted with it as belonging to customers. For example, consider a title transfer collateral arrangement where the title to a customer's property is posted as collateral and legal title is transferred to a clearing intermediary collecting the collateral. Despite the transfer of legal title from the customer to the clearing intermediary, the clearing intermediary must treat the property as customer collateral transferred by or on behalf of the customer relating to the customer's cleared derivatives.

Subsection 3(1) requires a clearing intermediary to segregate customer collateral from its own property, including from collateral advanced for a proprietary position. For example, a direct intermediary's proprietary positions (i.e., a house account) would be required to be held or accounted for separately from customer positions. Similarly, an indirect intermediary would be required to establish a separate account for its customers with its direct intermediary, so that the indirect intermediary's proprietary positions are held or accounted for separately from those of its customers. Records maintained by a clearing intermediary must make it clear that customer accounts are for the benefit of customers only.

Section 4 – Holding of customer collateral – clearing intermediary

Customer collateral posted by a clearing intermediary and held at a permitted depository may be commingled in an omnibus account (i.e., all of the clearing intermediary's customers' customer collateral is held in one omnibus account) if each customer's customer collateral is segregated on a recordkeeping basis. Additionally, the recordkeeping obligations in the Regulation require a clearing intermediary to identify the positions and the value of the collateral held for each customer within an omnibus customer account.

We expect that a clearing intermediary that holds customer collateral at a permitted depository in accordance with the Regulation would take reasonable efforts to confirm that the permitted depository:

- qualifies as a permitted depository under the Regulation;
- has appropriate rules, policies and procedures, including robust accounting practices, to help ensure the integrity of the customer collateral and minimize and manage the risks associated with the safekeeping and transfer of the collateral;
- maintains securities in an immobilised or dematerialised form for their transfer by book entry;
- protects customer collateral against custody risk through appropriate rules and procedures consistent with its legal framework;
- employs a robust system that ensures segregation between the permitted depository's own property and the property of its participants and segregation among the property of participants, and where supported by the legal framework, supports operationally the segregation of property belonging to a participant's customers on the participant's books and facilitates the transfer of customer collateral;
- identifies, measures, monitors, and manages its risks from other activities that it may perform;
- facilitates prompt access to customer collateral, when required.

If a clearing intermediary is a permitted depository, as defined in the Regulation, it may hold customer collateral itself and is not required to hold customer collateral at a third party depository. For example, a Canadian financial institution that acts as a clearing intermediary would be permitted to hold customer collateral provided it did so in accordance with the requirements of the Regulation. Where a clearing intermediary deposits customer collateral with a permitted depository, the clearing intermediary is responsible for ensuring the permitted depository maintains appropriate books and records to ensure customer collateral can be attributed to each customer.

Section 5 – Excess margin – clearing intermediary

We would interpret the requirement that a clearing intermediary identify and record the value of excess margin as applying only to the excess margin that the clearing intermediary holds. For example, a direct intermediary would not be required to keep records of the excess margin required from a customer by an indirect intermediary to which it provides clearing services.

Section 6 – Use of customer collateral – clearing intermediary

Under subsection 6(2), the use of customer collateral attributable to one customer to satisfy the obligations of another customer is not permitted. Although customer collateral may be held in one omnibus account, such collateral is not available to satisfy customer obligations generally. Therefore, a clearing model that allows recourse to a non-defaulting customer's collateral, including any model that permits fellow customer risk, violates this provision and would not be permitted to be offered to customers. For certainty, fellow customer risk is found in a clearing model that allows the customer collateral of a non-defaulting customer to be used to settle the obligations of a defaulting customer. The pooling of customer collateral held by a clearing intermediary pursuant to applicable bankruptcy and insolvency laws would not be considered use of customer collateral by the clearing intermediary and is permitted where required by applicable laws.

Subsection 6(3) allows a clearing intermediary to place a lien on customer collateral where the lien arises in connection with a cleared derivative. This exception recognizes that certain clearing arrangements involve the granting of security interests in customer collateral. A clearing intermediary is prohibited from imposing or permitting a lien that is not expressly permitted by the regulation on customer collateral and should such an improper lien be placed on customer collateral, the clearing intermediary must take all reasonable steps to promptly address the improper lien. However, a lien over excess collateral is not restricted where the lien is imposed to secure or extend credit to the customer.

Section 7 – Investment of customer collateral – clearing intermediary

Subsection 7(3) provides that any loss resulting from a permitted investment of customer collateral must not be borne by the customer. This requirement relates only to investments made by a clearing intermediary using customer collateral, not to collateral provided by a customer. For example, if a customer provided government bonds as collateral, and those bonds lost market value, the clearing intermediary would not be required to bear those losses. Similarly, where a customer provided collateral to a clearing intermediary and it was transformed into government bonds to be used as customer collateral posted to a regulated clearing agency, the clearing intermediary would not be required to bear any loss in market value of the transformed customer collateral.

Although losses in the value of invested customer collateral are not to be allocated to a customer, we are of the view that parties should be free to contract for the allocation of gains resulting from a clearing intermediary's investment activities in accordance with the Regulation.

Section 8 – Use of customer collateral – indirect intermediary default

An example of when a clearing intermediary may apply customer collateral to settle the obligations of a defaulting indirect intermediary is when a customer's default causes the default of the indirect intermediary. In such case, a direct intermediary could use the defaulting customer's collateral to satisfy the indirect intermediary's obligations attributable to the customer's default.

Section 9 – Acting as a clearing intermediary

Paragraph 9(1)(a) applies to a clearing intermediary that is prudentially regulated in a local jurisdiction. Prudential regulation by an authority in Canada should ensure that a clearing intermediary is adequately capitalized and has sufficient liquidity such that it is financially sound and does not present a significant solvency risk to customers. In Canada, prudential regulation of federally regulated financial institutions is undertaken by OSFI. Other regulators that perform prudential oversight include certain provincial prudential market regulators, such as the Autorité des marchés financiers in Québec, or other local securities regulatory authorities when the proposed registration regime for over-the-counter derivatives ("OTC derivatives") is implemented.

Paragraph 9(1)(c) applies to a clearing intermediary that is prudentially regulated and is subject to and in compliance with laws relating to clearing services and customer collateral in a permitted jurisdiction. This would include, for example, a futures commission merchant registered with the U.S. Commodity Futures Trading Commission ("CFTC") that is authorized by the CFTC to provide clearing services for OTC derivatives.

The CSA Derivatives Committee is developing a registration regime that will apply to clearing intermediaries. Once in force, subject to any available exemptions, we anticipate that registration will be required for clearing intermediaries to offer clearing services to local customers.

For greater certainty, pursuant to the application provision in paragraph 2(1)(b), the requirement under subsection 9(2) only applies to cleared derivatives involving local customers. Other than in British Columbia, Manitoba and Ontario, a foreign clearing intermediary may use a qualifying central counterparty instead of a regulated clearing agency if the foreign clearing intermediary qualifies for the exemption provided for in subsection 48(1) and otherwise complies with the requirements in subsection 48(2).

Section 10 – Risk management – clearing intermediary

We expect that rules, policies and procedures designed to identify, monitor and reasonably mitigate material risks arising from offering clearing services to an indirect intermediary and management of a default by an indirect intermediary would include all of the following:

- following industry standard best practices for understanding an indirect intermediary's: (i) identity and corporate structure, (ii) financial resources (e.g., by establishing credit and liquidity limits), (iii) product knowledge (e.g., by establishing a list of the indirect intermediary's products allowed to be cleared) and (iv) technical infrastructure (e.g., establishing adequate operational capacity and communication links between the indirect intermediary and the clearing intermediary);

- measuring and monitoring the positions of each indirect intermediary including (i) the daily valuation of the indirect intermediary's positions and cash flow obligations and (ii) market risk resulting from those positions;

- a default management plan which describes the steps followed in the event of an indirect intermediary's default.

Section 11 – Risk management – indirect intermediary

We expect that rules, policies and procedures designed to identify, monitor and reasonably mitigate material risks arising from offering indirect clearing services to customers would include all of the following:

- following industry standard best practices for understanding a customer's: (i) identity and corporate structure, (ii) financial resources (e.g., by establishing credit and liquidity limits), (iii) product knowledge (e.g., by establishing a list of the customer's products allowed to be cleared) and (iv) technical infrastructure (e.g., establishing adequate operational capacity and communication links between the customer and the indirect intermediary);

- measuring and monitoring the positions of each customer including (i) the daily valuation of the customer's positions and cash flow obligations and (ii) market risk resulting from those positions.

PART 3
RECORDKEEPING BY A CLEARING INTERMEDIARY

Part 3 outlines the minimum recordkeeping requirements that apply to clearing intermediaries. The effectiveness of the customer protections required under the Regulation is predicated on accurate and thorough recordkeeping by clearing intermediaries.

Section 12 – Retention of records – clearing intermediary

The records and supporting documentation related to a particular cleared derivative required to be prepared pursuant to this Part and Part 4 must be retained for at least 7 years from the date the cleared derivative expires or is terminated.

Any customer profiles, account agreements or other general information collected from a customer at any time the clearing intermediary provides clearing services for the customer, including prior to the date upon which the customer enters into a cleared derivative, must be kept for at least 7 years after the date upon which the customer's last derivative that is cleared by the clearing intermediary expires or is terminated.

All records and supporting documentation must be kept in accordance with industry best practices for record retention in Canada including safety and durability standards.

In Manitoba, the statutory minimum record retention period is 8 years.

Section 13 – Daily records – clearing intermediary

We are of the view that accurate recordkeeping requires, at minimum, daily valuations of customer collateral using industry standard best practice methodologies.

With respect to records required to be kept under paragraph 13(3)(b):

- subparagraph (i) refers to any revenue generated by the customer collateral, including, for example, dividend pay-outs relating to securities and coupon payments relating to debt instruments;

- subparagraph (ii) refers to any changes in the value of property forming part of the customer collateral, including, for example, an increase or decrease in the value of a security;

- subparagraph (iii) refers to charges that have accrued, or may accrue, that are payable by a customer and have been agreed to be paid by the customer in respect of the clearing services provided to the customer; such charges may include, for example, transaction or currency exchange charges or charges relating to the settlement or termination of a cleared derivative.

Section 18 – Identifying records – multiple clearing intermediaries

Where a clearing intermediary allows a person to act as an indirect intermediary, the clearing intermediary assumes recordkeeping obligations relating to the indirect intermediary and its customers. The effect of paragraphs 18(a) and (b) together is to enable the indirect intermediary to easily identify its own positions and property, and the positions and collateral held for, or on behalf, of each of its customers.

Section 19 – Records of investment of customer collateral – clearing intermediary

The date of the investment required to be recorded under paragraph 19(a) includes both the trade date and the settlement date. We are of the view that the requirement in paragraph 19(d) would be fulfilled by providing a unique identifier from an industry-accepted identifying standard, such as an ISIN or CUSIP number or, if an identifier is not available, a plain language description of each instrument or asset.

Pursuant to paragraph 7(2)(a) of the Regulation, each investment of customer collateral must be in a permitted investment.

Section 20 – Records of currency conversion – clearing intermediary

We expect that currency conversion trade records would include, at minimum, all of the following:

- the legal entity identifier ("LEI") of the customer or, if the customer is ineligible to obtain an LEI as determined by the Global Legal Entity Identifier System, the name of the customer;
- the date of the currency exchange;
- the amount and original currency of the funds to be exchanged;
- the exchange rate at which the currency exchange is made;
- the amount and new currency resulting from the exchange;
- the name of the institution which made the exchange or provided the exchange rate.

PART 4
REPORTING AND DISCLOSURE BY A CLEARING INTERMEDIARY

Part 4 outlines disclosure and reporting to be made by a clearing intermediary to customers, regulated clearing agencies and the local regulator or securities regulatory authority. Disclosure required to be provided to customers under this Part is not required on a transaction-by-transaction basis.

The written disclosure required under sections 21, 22, 23 and 27 is necessary only once upon the opening of each customer account, not prior to each cleared derivative transaction. If there are changes to the information contained in the disclosure a customer received, the customer must be promptly informed in writing of such changes. Where there are multiple clearing intermediaries, direct intermediaries and indirect intermediaries may provide disclosure either to a clearing intermediary closer in the clearing chain to the customer or directly to the customer. Written disclosure and notice of changes to such disclosure can be provided in electronic form by delivering copies of required materials or by providing links to online information to the customer or clearing intermediary.

Where clearing intermediaries are already engaged in cleared derivative transactions with regulated clearing agencies, other clearing intermediaries or customers before the Regulation comes into force, new written disclosure is not required to be delivered to customers if the written disclosure delivered prior to the Regulation coming into force meets the requirements for written disclosure set out in this Part. We acknowledge the confidential nature of the information reported to the local regulator or securities regulatory authority, and each regulator or securities regulatory authority intends to treat it as such, subject to applicable provisions of the legislation adopted by the local jurisdiction, including any applicable freedom of information and protection of privacy legislation. However, information may be shared with self-regulatory organizations or other relevant regulatory authorities.

Section 21 – Clearing intermediary delivery of disclosure by regulated clearing agency

Section 21 requires a clearing intermediary to provide disclosure, including investment guidelines and policies for investing customer collateral, received from a regulated clearing agency pursuant to sections 41 and 45 to its customer. Where there is a chain of clearing intermediaries, the direct intermediary may provide this disclosure to the indirect intermediary, which is then required to provide this disclosure to the customer. Both subsections 41(2) and 45(2) require a regulated clearing agency to disclose any changes to the information previously disclosed. A clearing intermediary is required to promptly send to its customers all of the information related to changes in the disclosure provided by a regulated clearing agency under sections 41 and 45.

Section 22 – Disclosure to customer by clearing intermediary

Customer collateral held at the clearing intermediary level may receive different treatment from customer collateral held at the regulated clearing agency in the event of a clearing intermediary's bankruptcy or insolvency. We expect that the disclosure required by this provision would provide customers with clear information on the treatment of their collateral in a default situation. For example, there may be situations where customer collateral held in a customer account maintained by a clearing intermediary would, pursuant to applicable bankruptcy laws, be combined with the property of other customers.

We expect that the information given in the written disclosure would assist customers in evaluating: (i) the level of protection provided, (ii) the manner in which segregation and the transfer of assets is achieved, including the method for determining the value at which customer positions will be transferred, and (iii) any risks or uncertainties associated with such arrangements.

Disclosure helps customers assess the related risks and conduct due diligence when entering into derivatives that are cleared at a regulated clearing agency through one or more clearing intermediaries. Examples of the information that we expect the disclosure would provide include all of the following:

- information about the clearing intermediary including its name, address and principal place of business and contact information;

- the bankruptcy and insolvency laws which apply to the clearing intermediary;

- any material risks which may impact the clearing intermediary's ability to transfer customer collateral and enforce rights in relation to customer collateral during a default, including an explanation of how such risks are material to the customer;

- a basic overview of the clearing intermediary's fund segregation and collateral management practices and policies;

- the process for recovering or transferring customer collateral should the clearing intermediary default;

- information regarding the proactive steps that a customer must take to protect its collateral;

- an explanation of the interaction of domestic and foreign laws applicable to customer collateral held by the clearing intermediary.

Section 23 – Disclosure to customer by indirect intermediary

In addition to the disclosure required under section 22, an indirect intermediary is required to disclose to its customers any additional material risks to a customer's positions and customer collateral that arise as a result of the indirect clearing relationship and an explanation of how such risks are material to the customer.

Section 24 – Customer information – clearing intermediary

In order to facilitate a timely transfer of collateral and positions in a default scenario, a regulated clearing agency should have sufficient information to identify each customer of a clearing intermediary and each customer's positions and customer collateral. Additionally, the obligation on a clearing intermediary under this section to provide information on the current value of its customers' positions and customer collateral includes indicating to the direct intermediary or regulated clearing agency, as applicable, where a customer is in default of its obligations.

We expect that identifying information required under this section would include the LEI of the customer or, if the customer is ineligible to obtain an LEI as determined by the Global Legal Entity Identifier System, the name or other identifier of the customer.

Section 25 – Customer collateral report – regulatory

Regular reporting on customer collateral deposits and holdings assists securities regulatory authorities in monitoring customer collateral arrangements and in developing and implementing rules to protect customer assets that are responsive to market practices. To that end, subsections 25(1) and 25(2) set out reporting requirements for direct intermediaries and indirect intermediaries, respectively, regarding customer collateral. A completed Form 94-102F1 or Form 94-102F2, as applicable, will provide the local securities regulatory authority with a snapshot of the value of collateral held or posted by each reporting clearing intermediary. In Ontario, Form 94-102F1 and Form 94-102F2 are required to be filed electronically through the Ontario Securities Commission's Electronic Filing Portal. Please see OSC Rule 11-501 *Electronic Delivery of Documents to the Ontario Securities Commission* for more information.[9]

Section 26 – Customer collateral report – customer

The customer collateral report required under this section could be made available to the customer or indirect intermediary through either direct electronic access available to the customer or indirect intermediary at any time or a daily report sent to the customer or indirect intermediary.

Section 27 – Disclosure of investment of customer collateral

We expect that the disclosure required under this section would include statements that customer collateral is permitted to be invested in accordance with section 7 of the Regulation and that any losses resulting from the clearing intermediary's investment of the customer collateral will not be borne or otherwise allocated to the customer.

We are of the view that the requirement to provide disclosure under subsection 27(1) and subsection 27(2) may be satisfied by directing a customer or, if applicable, the indirect intermediary to the disclosure on the clearing intermediary's website.

PART 5
TREATMENT OF COLLATERAL BY A REGULATED CLEARING AGENCY

Part 5 contains requirements for the treatment of customer collateral by regulated clearing agencies.

Section 28 – Collection of initial margin

The requirement that a regulated clearing agency collect initial margin on a gross basis for each customer means that a regulated clearing agency may not, and may not permit its direct intermediaries to, offset initial margin positions of different customers against one another. However, the initial margin collected from a customer may be determined by netting across the various cleared derivative positions of that customer. Further, a regulated clearing agency is not prohibited from collecting variation margin for cleared derivatives on a net basis from its direct intermediaries.

Margin requirements are determined by the regulated clearing agency in accordance with its rules, policies and procedures. For further discussion, please see *Regulation 24-102 respecting Clearing Agency Requirements* (chapter V-1.1, r. 8.01) ("Regulation 24-102") for requirements applicable to clearing agency margin calculation.

Section 29 – Segregation of customer collateral – regulated clearing agency

Records maintained by the regulated clearing agency must make it clear that customer accounts are for the benefit of customers only.

We are of the view that parties should have the benefit of flexibility in their collateral arrangements. However, the principle remains that notwithstanding the legal arrangement under which customer collateral is posted with a regulated clearing agency, the regulated clearing agency must treat customer collateral posted with it as belonging to customers. For example,

[9] OSC Rule 11-501 *Electronic Delivery of Documents to the Ontario Securities Commission*, online: Ontario Securities Commission (http://www.osc.gov.on.ca/en/SecuritiesLaw_11-501.htm).

consider a title transfer collateral arrangement where the title to the customer's property is posted as collateral and legal title is transferred to a regulated clearing agency collecting the collateral. Despite the transfer of legal title from the customer (or clearing intermediary on behalf of the customer) to the regulated clearing agency, the regulated clearing agency must treat the property as customer collateral transferred by, for or on behalf of the customer relating to the customer's cleared derivatives.

Section 30 – Holding of customer collateral – regulated clearing agency

A regulated clearing agency is a permitted depository under the Regulation and may hold collateral itself if it offers depository services. Accordingly, a regulated clearing agency is not required to hold customer collateral at a third-party permitted depository.

The customer collateral of multiple customers may be commingled in an omnibus customer account if each customer's customer collateral is segregated on a recordkeeping basis. Additionally, the recordkeeping obligations in the Regulation require the regulated clearing agency to identify the positions and the value of the collateral held for each individual customer within an omnibus customer account.

We expect that a regulated clearing agency that holds customer collateral at a third-party permitted depository in accordance with the Regulation would take reasonable efforts to confirm that the permitted depository:

- qualifies as a permitted depository under the Regulation;

- has appropriate rules, policies and procedures, including robust accounting practices, to help ensure the integrity of the customer collateral and minimize and manage the risks associated with the safekeeping and transfer of the collateral;

- maintains securities in an immobilised or dematerialised form for their transfer by book entry;

- protects customer collateral against custody risk through appropriate rules and procedures consistent with its legal framework;

- employs a robust system that ensures segregation between the permitted depository's own property and the property of its participants and segregation among the property of participants, and where supported by the legal framework, supports operationally the segregation of property belonging to a participant's customers on the participant's books and facilitates the transfer of customer collateral;

- identifies, measures, monitors, and manages its risks from other activities that it may perform; and

- facilitates prompt access to customer collateral, when required.

Paragraph 30(b) requires a regulated clearing agency to hold customer collateral relating to cleared derivatives separately from any other type of property that is not customer collateral, including any other property posted by a customer as collateral relating to another investment or financial instrument that is not a cleared derivative. For example, the customer collateral of a customer may be commingled in an omnibus account with the customer collateral of another customer but may not be commingled with collateral belonging to the customer or any other customer relating to a futures contract.

Section 31 – Excess margin – regulated clearing agency

We would interpret the requirement that a regulated clearing agency identify and record the value of excess margin as applying only to the excess margin that the regulated clearing agency holds. For example, a regulated clearing agency would not be required to keep records relating to excess margin held by a clearing intermediary.

Section 32 – Use of customer collateral – regulated clearing agency

Under subsection 32(2), subject to an exception for excess collateral, regulated clearing agencies are only permitted to apply a customer's customer collateral to the cleared derivatives of that customer. Accordingly, the Regulation prohibits the cross-margining of a customer's cleared derivatives and futures positions. The reasoning for this is that the regulatory framework applicable to futures in certain jurisdictions, including Canada, may make customers more susceptible to shortfalls in the event of a clearing intermediary's insolvency and therefore cross-margining could undermine a customer's ability to port its cleared derivatives positions. However, in some jurisdictions, customer protection requirements applicable to futures are equivalent to those applicable to cleared derivatives. Under such regimes, cross-margining may not represent a material risk to porting a customer's positions in cleared derivatives. Therefore, when considering an application for discretionary relief from the prohibition on cross-margining or when making an equivalence determination of a foreign jurisdiction's regulatory requirements for the purpose of substituted compliance, the regulator or securities regulatory authority will take these factors into account.

Use of customer collateral attributable to one customer to satisfy the obligations of another customer is not permitted. Although customer collateral may be held in one omnibus account, such collateral is not available to satisfy customer obligations generally. Therefore, a clearing model that allows recourse to a non-defaulting customer's collateral, including any model that permits fellow customer risk, violates this provision and would not be permitted to be offered to customers. For certainty, fellow customer risk is found in a clearing model that allows the customer collateral of a non-defaulting customer to be used to settle the obligations of a defaulting customer. The pooling of customer collateral held by a regulated clearing agency pursuant to applicable bankruptcy and insolvency laws would not be considered use of customer collateral by the regulated clearing agency and is permitted where required by applicable laws.

Subsection 32(3) allows a regulated clearing agency to place a lien on customer collateral where the lien arises in connection with a cleared derivative. This exception recognizes that certain clearing arrangements involve the granting of security interests in customer collateral. A regulated clearing agency is prohibited from imposing or permitting a lien that is not expressly permitted by the Regulation on customer collateral and should such an improper lien be placed on customer collateral, the regulated clearing agency must take all reasonable steps to promptly address the improper lien. However, a lien over excess collateral is not restricted where the lien is imposed to secure or extend credit to the customer.

Section 33 – Investment of customer collateral – regulated clearing agency

Subsection 33(3) provides that any loss resulting from a permitted investment of customer collateral must not be borne by the customer. This requirement relates only to investments made by a regulated clearing agency using customer collateral, not to collateral provided by a customer. For example, if a customer provided government bonds as collateral, and those bonds lost market value, the regulated clearing agency would not be required to bear those loses. Similarly, where a customer provided collateral to a regulated clearing agency and it was transformed into government bonds to be used as customer collateral, the regulated clearing agency would not be required to bear any loss in market value of the transformed customer collateral.

Although losses in the value of invested customer collateral are not to be allocated to a customer, we are of the view that parties should be free to contract for the allocation of gains resulting from a regulated clearing agency's investment activities in accordance with the Regulation. Where a regulated clearing agency's rules provide for investment loss mutualisation and allocation to clearing intermediaries, this would not violate the requirement.

Section 34 – Use of customer collateral – clearing intermediary default

An example of when a regulated clearing agency may apply customer collateral to settle the obligations of a defaulting clearing intermediary is when a customer's default causes the default of the clearing intermediary, whether directly or through the default of an indirect intermediary. In such case, a regulated clearing agency could use the defaulting customer's collateral, including its customer collateral under the Regulation, to satisfy the clearing intermediary's obligations attributable to the customer's default.

Section 35 – Risk management –Regulation 24-102 applies

Regulation 24-102 applies to all regulated clearing agencies providing clearing services to local customers, including to clearing agencies that are exempt from recognition if they clear derivatives for customers.

PART 6
RECORDKEEPING BY A REGULATED CLEARING AGENCY

Part 6 outlines the minimum recordkeeping requirements that apply to regulated clearing agencies. The effectiveness of the customer protections required under the Regulation is predicated on accurate and thorough recordkeeping by regulated clearing agencies.

Section 36 – Retention of records – regulated clearing agency

All records prepared pursuant to this Part and Part 7 must be kept in accordance with industry best practices for record retention in Canada including safety and durability standards.

Since clearing intermediaries are required to maintain records and supporting documentation related to cleared derivatives of their customers for at least 7 years pursuant to section 12, it is not necessary for a regulated clearing agency to retain records after the related cleared derivatives expire or are terminated. It would be redundant for both clearing intermediaries and regulated clearing agencies to keep records for an extended period after expiry or termination of a cleared derivative or after the clearing relationship with a customer ends.

Section 37 – Daily records – regulated clearing agency

We are of the view that accurate recordkeeping requires, at minimum, daily valuations of customer collateral using industry standard best practice methodologies.

With respect to records required to be kept under paragraph 37(2)(b):

- subparagraph (i) refers to any revenue generated by the customer collateral, including, for example, dividend pay-outs relating to securities and coupon payments relating to debt instruments;

- subparagraph (ii) refers to any changes in the value of property forming part of the customer collateral, including, for example, an increase or decrease in the value of a security; and

- subparagraph (iii) refers to charges that have accrued, or may accrue, that are payable by a customer of a direct intermediary and have been agreed to be paid by the customer in respect of the clearing services provided to the customer; such charges may include, for example, transaction or currency exchange charges or charges relating to the settlement or termination of a cleared derivative.

Section 38 – Identifying records – regulated clearing agency

A regulated clearing agency has recordkeeping obligations relating to all customers for which it clears cleared derivatives. The recordkeeping requirement under section 38 extends to any customer collateral held in an account of the regulated clearing agency at a third-party permitted depository.

Paragraph (c) ensures that direct and indirect customers receive equal treatment. Direct intermediaries are required under section 18 to make this information available to indirect intermediaries to which they provide clearing services.

Section 39 – Records of investment of customer collateral – regulated clearing agency

The date of the investment required to be recorded under paragraph 39(a) includes both the trade date and the settlement date. We are of the view that the requirement in paragraph 39(d) would be fulfilled by providing a unique identifier from an industry-accepted identifying

standard, such as an ISIN or CUSIP number or, if an identifier is not available, a plain language description of each instrument or asset.

Pursuant to paragraph 33(2)(a) of the Regulation, each investment of customer collateral must be in a permitted investment.

Section 40 – Records of currency conversion – regulated clearing agency

We expect that currency conversion trade records would include, at minimum, all of the following:

- LEI of the customer or, if the customer is ineligible to obtain an LEI as determined by the Global Legal Entity Identifier System, the name of the customer;
- the date of the currency exchange;
- the amount and original currency of the funds to be exchanged;
- the exchange rate at which the currency exchange is made;
- the amount and new currency resulting from the exchange;
- the name of the institution which made the exchange or provided the exchange rate.

PART 7
REPORTING AND DISCLOSURE BY A REGULATED CLEARING AGENCY

Part 7 outlines certain disclosure and reporting to be made by a regulated clearing agency to customers, clearing intermediaries and the local regulator or securities regulatory authority. Disclosure required to be provided to customers under this Part is not required on a transaction-by-transaction basis.

The written disclosure required under sections 41 and 45 is necessary only once upon the opening of each customer account, not prior to each cleared derivative transaction. If there are changes to the information contained in the disclosure a customer received, the customer must be promptly informed in writing of such changes. Where there are multiple clearing intermediaries, a direct intermediary may provide disclosure either to a clearing intermediary closer in the clearing chain to the customer or directly to the customer. Written disclosure and notice of changes to such disclosure can be provided in electronic form by delivering copies of required materials or by providing links to online information to the customer or direct intermediary.

Where a regulated clearing agency is already providing clearing services before the Regulation comes into force, new written disclosure is not required to be delivered to customers if the written disclosure delivered prior to the Regulation coming into force meets the requirements for written disclosure set out in this Part.

We acknowledge the confidential nature of the information reported to the local regulator or securities regulatory authority, and each regulator or securities regulatory authority intends to treat it as such, subject to applicable provisions of the legislation adopted by the local jurisdiction, including any applicable freedom of information and protection of privacy legislation. However, information may be shared with self-regulatory organizations or other relevant regulatory authorities.

Section 41 – Disclosure to direct intermediaries by regulated clearing agency

We expect that the information given in the written disclosure would assist customers in evaluating: (i) the level of protection provided, (ii) the manner in which segregation and the transfer of assets is achieved, including the method for determining the value at which customer positions will be transferred, and (iii) any risks or uncertainties associated with such arrangements.

Disclosure helps customers assess the related risks and conduct due diligence when entering into derivatives that are cleared through a direct intermediary of the regulated clearing

agency. Examples of the information that we expect the disclosure would provide include all of the following:

- information about the regulated clearing agency including its name, address and principal place of business and contact information;

- a basic overview of the regulated clearing agency's rules, policies and procedures concerning segregation and portability of customers' positions and customer collateral including an explanation of any legal or operational constraints that may impair the ability of the regulated clearing agency to segregate or transfer the positions and related customer collateral of a customer;

- which bankruptcy and insolvency laws apply to the regulated clearing agency and an analysis of applicable laws governing the regulated clearing agency's clearing services including whether the regulated clearing agency is described or named under the *Payment and Clearing Settlement Act* (Canada);[10]

- the regulated clearing agency's rule book;

- information on the regulated clearing agency's rules and procedures for defaults including the process for recovering or transferring customer collateral should a clearing intermediary default and the size and composition of the financial resource package available in the event of a clearing intermediary's default; and

- the interaction of domestic and foreign laws applicable to customer collateral held by the regulated clearing agency and any other information relevant to using the regulated clearing agency's clearing services.

The written disclosure required under subsection 41(1), is necessary only upon the opening of each customer account, or upon any change to the rules, policies or procedures of the regulated clearing agency, rather than prior to each cleared derivative transaction.

Section 42 – Customer information – regulated clearing agency

In order to facilitate a timely transfer of collateral and positions in a default scenario, we expect that a regulated clearing agency would receive complete and timely information from a direct intermediary under subsection 24(1) to identify each customer of a clearing intermediary, and the customer's positions and customer collateral.

Section 43 – Customer collateral report – regulatory

Regular reporting on customer collateral deposits and holdings assists securities regulatory authorities in monitoring customer collateral arrangements and in developing and implementing rules to protect customer assets that are responsive to market practices. To that end, section 43 sets out reporting requirements for regulated clearing agencies regarding customer collateral. A completed Form 94-102F3 will provide the local securities regulatory authority with a snapshot of the value of collateral held or posted by the regulated clearing agency. In Ontario, Form 94-102F3 is required to be filed electronically through the Ontario Securities Commission's Electronic Filing Portal. Please see OSC Rule 11-501 *Electronic Delivery of Documents to the Ontario Securities Commission* for more information.[11]

Section 44 – Customer collateral report – direct intermediary

The customer collateral report required under this section could be made available to a direct intermediary through either direct electronic access available to the direct intermediary at any time or a daily report sent to the direct intermediary.

Section 45 – Disclosure of investment of customer collateral

We expect that the disclosure required under this section would include statements that customer collateral is permitted to be invested in accordance with section 33 of the Regulation

[10] *Payment and Clearing Settlement Act* (SC 1996 c 6 sch).
[11] *Supra* note 9.

and that any losses resulting from the regulated clearing agency's investment of the customer collateral will not be borne or otherwise allocated to the customer. We are of the view that the requirements to provide disclosure under subsection 45(1) and subsection 45(2) may be satisfied by directing a customer to the disclosure on the regulated clearing agency's website.

PART 8
TRANSFER OF POSITIONS

Part 8 provides for the transfer of customer collateral and positions from one clearing intermediary to another, either in a default scenario or upon request of the customer.

The efficient and complete transfer of customer collateral and related positions is important in both pre-default and post-default scenarios but is particularly critical during a clearing intermediary's default or when it is undergoing insolvency proceedings.

Section 46 – Transfer of customer collateral and positions

It is our expectation that customer collateral and positions be transferred as seamlessly as possible from the perspective of the customer. This means that we expect that a customer's positions would be maintained on identical economic terms as governed the positions immediately before the transfer. In effecting such a transfer, a regulated clearing agency is permitted to operationally close-out and re-book the positions, provided that the ultimate result is that the customer's positions are maintained on identical economic terms as governed immediately before the transfer.

The regulated clearing agency's ability to transfer customer collateral and related positions in a timely manner may depend on such factors as market conditions, sufficiency of information on the individual constituents, and the complexity or size of the customer's portfolio. We would therefore expect the regulated clearing agency to structure its arrangements for the transfer of customer collateral and positions in a way that makes it highly likely that they will be effectively transferred to one or more other direct intermediaries, taking into account all relevant circumstances. In order to achieve a high likelihood of transferability, the regulated clearing agency would need to have the ability to (i) identify the positions belonging to each customer, (ii) identify and assert the regulated clearing agency's rights to related customer collateral held by or through the regulated clearing agency, (iii) transfer positions and related customer collateral to one or more other direct intermediaries, (iv) identify potential direct intermediaries to accept the positions, (v) disclose relevant information to such direct intermediaries so that they can evaluate the counterparty credit and market risk associated with the customers and positions, respectively and (vi) carry out its default management procedures in an orderly manner. We expect that regulated clearing agency's policies and procedures would provide for the proper handling of customer collateral and related positions of customers of a defaulting direct intermediary.

We expect that operations, policies and procedure of clearing intermediaries and regulated clearing agencies be structured to ensure, to the greatest extent possible, that a default by a clearing intermediary does not affect the positions and collateral of the defaulting clearing intermediary's customers. Generally, default by a direct intermediary would occur when it does not, or is unable to, meet its obligations at a regulated clearing agency.

To ensure that a customer's positions and customer collateral are insulated from a direct intermediary's default, including any winding-up or restructuring proceeding of the defaulting direct intermediary, we expect that a regulated clearing agency would be structured, including by having the necessary rules and procedures in place, to effectively and promptly facilitate the transfer of customer collateral and positions to a direct intermediary that (i) is not in default, as that term is defined in the rules and procedures of the relevant regulated clearing agency and (ii) is not reasonably expected to default on its obligations at a regulated clearing agency as they come due.

Although we stress the importance of the transfer of a customer's positions and customer collateral in a default scenario, we acknowledge that there may be circumstances where the portability of all or a portion of a customer's positions is not possible. Where a regulated clearing agency is not able to transfer positions within a pre-defined transfer period specified in its operating rules, it may take all steps permitted by its rules to actively manage its risks in relation

to those positions, including liquidating the customer collateral and positions of the defaulting direct intermediary's customers.

We expect that a direct intermediary would also have policies and procedures in place to facilitate the prompt transfer of customer collateral that it holds to one or more direct intermediaries in the event of its own default.

Where a transfer of customer collateral and positions is facilitated under subsection 46(1), the Regulation requires that reasonable efforts are made to ensure that the customer's instructions are followed with respect to the transfer of the customer's positions and customer collateral to a particular transferee direct intermediary. We are of the view that these instructions may be best obtained at the outset of a clearing relationship, and by allowing a customer to identify direct intermediaries to which it consents *a priori* to such a transfer. If there are circumstances where such instructions would not be obtained, or where a customer's prior instructions would not be followed, we expect those circumstances would be set out in the rules, policies or procedures of the regulated clearing agency. In a default scenario, where a customer has not provided instructions or the transfer of a customer's collateral and positions in accordance with its instructions is not possible, a regulated clearing agency or a direct intermediary may rely on the customer's negative consent (i.e., the customer's silence) in effecting a transfer.

Additionally, a regulated clearing agency or defaulting direct intermediary may promptly transfer the customer's positions and related customer collateral, as a single portfolio or in portions to one or more direct intermediaries.

A regulated clearing agency must have the necessary policies and procedures in place, to facilitate the transfer of the customer collateral and positions of a customer from one direct intermediary to another at the request of the customer. This is also known as a "business-as-usual transfer".

We expect that a customer be able to transfer its customer collateral and positions to another direct intermediary in the normal course of business. Subsection 46(2) requires that a regulated clearing agency be structured, including by having the necessary rules and procedures in place, to facilitate the transfer of customer collateral and related positions upon the customer's request to any one or more non-defaulting direct intermediaries, subject to any notice or other contractual requirements.

Where a business-as-usual transfer of a customer's positions and customer collateral is facilitated under subsection 46(2), we would expect that a regulated clearing agency would promptly transfer the customer's positions and related customer collateral as a single portfolio or in portions to one or more direct intermediaries, as requested by the customer.

A request from a customer to facilitate a business-as-usual transfer of the customer's positions and customer collateral to a particular transferee direct intermediary may also take the form of a consent to transfer obtained by the regulated clearing agency from the customer. When obtaining the consent of the receiving direct intermediary, we would expect the consent to contain information as to which positions and customer collateral are to be transferred.

Section 47 – Transfer from a clearing intermediary

We are of the view that customers of a clearing intermediary should benefit from protections and rights under the Regulation with respect to the transfer of their positions and customer collateral. To that end, in the event of the clearing intermediary's default, the clearing intermediary must be structured to promptly facilitate such a transfer, as a single portfolio or in portions as requested by the customer, to one or more non-defaulting clearing intermediaries.

PART 9
SUBSTITUTED COMPLIANCE

Section 48 – Substituted Compliance

Subsection 48(1) contemplates an exemption from the Regulation in the form of substituted compliance for foreign clearing intermediaries that are regulated under the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the

Regulation. Substituted compliance applies to the provisions of the Regulation where the clearing intermediary is in compliance with the laws of a foreign jurisdiction set out in Appendix A opposite the name of the foreign jurisdiction. The foreign jurisdictions specified for substituted compliance are determined on a jurisdiction by jurisdiction basis, and depend on a review of the laws and regulatory framework of the jurisdiction.

The exemption only applies where a clearing intermediary is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix A and does not incorporate any exemption or discretionary relief granted to a clearing intermediary in connection with the laws of the foreign jurisdiction. Where a clearing intermediary relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix A, it will need to apply to the relevant securities regulatory authorities for similar exemptive or discretionary relief from the Regulation.

In respect of a local customer in a local jurisdiction other than British Columbia, Manitoba and Ontario, a clearing intermediary registered, licensed or otherwise permitted to act as a clearing intermediary in a jurisdiction set out in Appendix A may benefit from substituted compliance under subsection 48(1), if the clearing intermediary offers clearing services to local customers through either a clearing agency that is a qualifying central counterparty or a regulated clearing agency.

Subsection 48(3) contemplates an exemption from the Regulation in the form of substituted compliance for foreign regulated clearing agencies that are recognized or exempt from recognition by a Canadian securities regulatory authority and are in compliance with the laws of a foreign jurisdiction that achieve substantially the same objectives, on an outcomes basis, as the Regulation. Substituted compliance applies to the provisions of the Regulation where the regulated clearing agency is in compliance with the laws of a foreign jurisdiction set out in Appendix A opposite the name of the foreign jurisdiction.

The exemption only applies where a regulated clearing agency is in compliance with the requirements of the laws of the applicable foreign jurisdiction specified in Appendix A and does not incorporate any exemption or discretionary relief granted to a regulated clearing agency in connection with the laws of the foreign jurisdiction. Where a regulated clearing agency relies on an exemption or discretionary relief from the laws of a foreign jurisdiction set out in Appendix A, it will need to apply to the relevant securities regulatory authorities for similar exemptive or discretionary relief from the Regulation.

In accordance with subsections 48(2) and 48(4), the “residual” provisions listed in Appendix A must be complied with when providing clearing services for a local customer, even if a foreign clearing intermediary or foreign regulated clearing agency is in compliance with the laws of a foreign jurisdiction set out in Appendix A.