Submission by Chicago Mercantile Exchange Inc. (CME) in response to Proposed National Instrument 94-102 and Proposed Companion Policy 94-102CP, *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*

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19 April 2016

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
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Re: ***CSA Notice and Request for Comment: Proposed National Instrument 94-102 and Proposed Companion Policy 94-102CP, Derivatives: Customer Clearing and Protection of Customer Collateral and Positions***

To all interested parties:

CME Group Inc. ("CME Group") appreciates the opportunity to provide comments on the Canadian Securities Administrators' (the "CSA") *Proposed National Instrument 94-102 ("*Proposed NI*") and Proposed Companion Policy 94-102CP ("*Proposed CP*"), Derivatives: Customer Clearing and Protection of Customer Collateral and Positions*. The Proposed NI and Proposed CP are referred to herein collectively as Proposed NI 94-102.

CME Group is the parent of Chicago Mercantile Exchange Inc. ("CME") and of CME's clearing division ("CME Clearing"). CME Clearing is one of the largest central counterparty ("CCP") clearing services for regulated derivatives contracts, offering clearing and settlement services for exchange-traded derivatives contracts and for over-the-counter ("OTC") derivatives transactions, including interest rate swaps, credit default swaps, agricultural swaps, and other OTC contracts. The U.S. Commodity Futures Trading Commission ("CFTC") is the primary regulator for CME's clearing operations. CME is exempt

from the requirement to be recognized as a clearing agency in Ontario under Section 147 of the *Securities Act* (Ontario). CME is also exempt from the requirement to be recognized as a clearing house under section 12 of the *Derivatives Act* (Quebec) and the derivatives qualification requirement and the derivatives authorization requirement under section 82 of the *Derivatives Act* (Quebec).

Introduction

CME Group fully supports the fundamental principle behind Proposed NI 94-102 of protecting customer positions and collateral. Our primary concern with Proposed NI 94-102 is the possibility for significant regulatory overlap and duplicative requirements depending on how the CSA apply substitute compliance. As the CSA recognize in their notice accompanying the proposed instrument, OTC derivatives clearing infrastructure and service providers are largely concentrated outside of Canada, primarily in the United States and the European Union. We believe the activities of CME Clearing involving local Canadian counterparties are already subject to requirements analogous in all materials respects to those set forth in Proposed NI 94-102 by virtue of applicable US laws and regulations. While narrower in scope than the CSA's Proposed Model Rule[1], we are concerned that Proposed NI 94-102 could still impose a burden on clearing intermediaries and regulated clearing agencies (including overlapping and duplicative requirements) that could deter participants from offering clearing services to Canadian local counterparties absent a broad application of substitute compliance.

Substitute Compliance

We appreciate the CSA proposing substitute compliance as a way to minimize compliance burdens for equivalently regulated foreign market clearing providers. We would encourage the CSA to take an outcomes-based approach to substitute compliance determinations without requiring strict equivalence between Proposed NI 94-102 and the applicable provisions of foreign law as a condition to granting equivalence. Imposing a layer of potentially duplicative or conflicting regulatory requirements on foreign clearing agencies that wish to clear derivatives on behalf of Canadian local counterparties would run contrary to the stated regulatory goal of encouraging central clearing of OTC derivatives. Many of the provisions of Proposed NI 94-102, if applied to cross-border activity with local Canadian counterparties, could discourage foreign participation in Canadian derivatives markets and potentially limit Canadian market participants' access to global clearing infrastructure and intermediaries.

We understand that the CSA propose to implement substitute compliance on rule by rule basis. Specifically, the CSA propose to include an Appendix to the final national instrument that will list specific provisions of foreign law that can be observed by eligible clearing agencies in order to satisfy their obligations under the corresponding provisions of the national instrument. We would encourage the CSA to amend Proposed NI 94-102 to allow, where appropriate, for more broad-based substitute compliance decisions that cover the customer clearing regimes of foreign jurisdictions as a whole (as

[1] References in this letter to the "Proposed Model Rule" are to the CSA OTC Derivatives Committee's *Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Positions and Collateral* published on January 16, 2014 as CSA Notice 91-304.

opposed to on a rule by rule basis). Such a holistic approach would allow a foreign clearing agency to satisfy the requirements of Proposed NI 94-102 by adhering to the same requirements when dealing with Canadian local counterparties that it applies when transacting with clients in its own home jurisdiction (e.g., the US). If there were particular areas where foreign requirements were not considered sufficient by the CSA, the CSA could impose conditions on any substituted compliance decision. However, we believe such an approach (as opposed to a rule by rule approach) would greatly simplify the implementation of substitute compliance, particularly in the case of jurisdictions where the CSA conclude there is significant overlap between the requirements of that foreign regime and the requirements contemplated in Proposed NI 94-102.

Portfolio Margining

We reiterate concerns raised by commenters in the context of the Proposed Model Rule about imposing a prohibition on portfolio margining. We believe portfolio margining of OTC derivatives with other products such as futures can provide important commercial benefits to market participants (such as capital savings) without significantly increasing the risk of customer shortfalls in the event of a clearing intermediary's default. CME Clearing has obtained relief for this type of cross-margining from the CFTC. In reliance on that relief, CME Clearing currently offers its US customers the ability to cross-margin across nineteen cleared OTC interest rate swap currencies, CBOT treasury futures, CME Eurodollar futures and USD deliverable swap futures.

Section 32 of Proposed NI 94-102 would not permit cross-margining of futures and OTC cleared derivatives (although discretionary relief is contemplated in Section 32 of the Proposed CP). To reduce the regulatory burden on foreign clearing agencies, we would encourage the CSA where appropriate to recognize existing foreign exemptive relief as part of its substitute compliance determinations so that foreign clearing agencies do not have to apply for the same relief in order to make cross-margining available to local Canadian participants (both for clearing intermediaries and clients). Given the effort and expense required to obtain separate relief from Canadian securities regulatory authorities to extend cross-margining to local Canadian counterparties, foreign clearing agencies may decide not to make this option available in Canada. For Canadian clearing intermediaries and clients that utilize portfolio margining today, this element of Proposed NI 94-102 would restrict them from continuing to do so (at least temporarily until exemptive relief is obtained).

If cross-margining is not permitted for Canadian local counterparties, clearing agencies will have to implement controls to prevent Canadians from accessing their offerings. For CME Group, this process of identifying Canadian clients and blocking access would be highly manual. The additional time and resources required for clearing agencies to block access for Canadian accounts would deter firms from making clearing services available to Canadian clients. We submit that Canadian local customers would benefit from being able to access the cross-margining of futures and OTC derivatives made available by CME. We note that futures which are portfolio margined with OTC swaps receive protections applicable to OTC swaps, including a longer five day margin period of risk (as opposed to the normal one day for

futures)[2]. Canadian clients would be subjected to significantly higher margin requirements if their futures and swaps cannot be commingled and cross-margined. We would ask the CSA to consider this fact, and the potential operational and implementation burden involved in blocking access for Canadian accounts, when addressing the issues of commingling and cross-margining in the final national instrument.

Segregation of "Customer Collateral"

CME Group believes it is important for Proposed NI 94-102 to differentiate between customer collateral (that is deposited to satisfy margin requirements such as initial margin) and cash or other assets that are paid or deposited to settle the change in price of an open OTC derivatives contract over a settlement cycle. Annex A of the CSA Notice and Request for Comment that accompanied the publication of Proposed NI 94-102 includes a discussion of the comments received on the Proposed Model Rule and the CSA's responses to those comments. With respect to the definition of "customer collateral", the CSA state that "variation margin provided by a customer to its clearing intermediary is customer collateral and required to be segregated."

In all cases, US DCOs must segregate customer initial and variation margin from house initial and variation margin. It is not clear whether the Proposed Instrument requires only this level of segregation or contemplates segregation of customer variation margin payments from other customers of the same clearing member. We recommend against the latter approach as it would result in gross or individual settlement of variation payments on behalf of each customer. CME Clearing and other CCPs settle the customer origin settlement variation requirements for each clearing member on a net basis.

Investment Losses

Section 33 of the Proposed CP explains that any investment losses incurred as a result of a permitted investment by a regulated clearing agency must be borne by the regulated clearing agency and not the customer. It goes on to say that, while such losses may not be passed on to customers, it is permissible for the losses to be mutualised and allocated among clearing intermediaries (presumably by contract). We would note that under equivalent US rules the regulated clearing agency (or DCO) must incur the loss and no provision is made for mutualisation among clearing members. We would request that the CSA reconsider whether the proposal in Section 33 of the Proposed CP to permit mutualisation of such losses among clearing members is appropriate from a risk management and policy perspective or if such losses should always be borne by the regulated clearing agency.

Record Retention

[2] Margin period of risk (MPOR) refers to the period of time from the most recent exchange of collateral covering a exposure to financial instruments with a defaulting counterparty until the financial instruments are closed out and the resulting market risk is re-hedged.

Proposed NI 94-102 contemplates a seven year period for retention of records for all regulated clearing agencies that fall within its scope. CME Group would note that the equivalent record keeping requirements under applicable US laws is five years. While we understand that seven years may apply in other areas of Canadian securities regulation, we believe the regulatory burden associated with requiring two additional years for regulated clearing agencies doing business with local Canadian counterparties is disproportionate and, as noted above, a disincentive for foreign firms to continue to provide clearing services into Canada. We would request that the CSA consider reducing the retention period from seven years to five years or, in the context of granting substituted compliance determinations, permit US record retention requirements to suffice for purposes of compliance by foreign clearing agencies.

We also request that the timeline apply and be measured in relation to each individual transaction. Section 36 of the Proposed CP would require that records for all transactions be retained "for at least 7 years after the date upon which a customer's last cleared derivative expires or terminates". In the context of a long-term customer relationship, this could require regulated clearing agencies to maintain records for the relevant customer transactions far beyond a seven year period. We believe the timeline should apply in respect of each individual transaction and would ask the CSA to consider revising Proposed NI 94-102 accordingly.

We would also ask the CSA to clarify the meaning of "in a readily accessible location" in paragraph 36 of Proposed NI 94-102. We note that under regulations application to US derivatives clearing organizations, records are required to be readily accessible via real time electronic access throughout the life of a swap and for two years following the final termination of the swap; thereafter they are required to be retrievable within three business days through the remainder of the period following final termination of the swap during which the record is required to be kept.

We would also request that the CSA clarify the scope of the records which regulated clearing agencies are required to retain under section 36 of Proposed NI 94-102. For example, a great deal of customer information is collected by clearing intermediaries and then shared by those clearing intermediaries with the regulated clearing agency. This is true of the customer information which a direct intermediary must provide to a regulated clearing agency under section 24 of Proposed NI 94-102. While regulated clearing agencies receive this information in connection with clearing customer transactions, we believe the record retention requirement should fall on the clearing intermediaries. We would request that the CSA revise section 36 of Proposed NI 94-102 and the corresponding provisions in the Proposed CP to reflect this allocation of responsibility for record retention.

Books and Records – Collateral Information

Section 37(1)(2) of Proposed NI 94-102 requires a regulated clearing agency to record in its books and records certain customer collateral information for each customer. We believe that the level of detail contemplated is not appropriate or necessary given the type of customer segregation model which is permitted under section 29 of Proposed NI 94-102. Pursuant to section 29 and the related provisions in the Proposed CP, regulated clearing agencies must segregate customer collateral but may also

commingle collateral of multiple customers in an omnibus customer account. This model is similar to the LSOC (legally separate, operationally commingled) model followed under the rules of the CFTC in the US. In the context of such a regime, we believe it is adequate to record the value of collateral attributable to each customer. However, section 37(2) of Proposed NI 94-102 also requires regulated clearing agencies to record a description of the customer collateral held at each permitted depository. In the corresponding provisions of the Proposed CP, it says that this description should include "an industry standard security identifier such as a CUSIP or ISIN code or, if an identifier is not available, a plain language description of the collateral." We would submit that identifying specific items of collateral attributable to individual customers is inconsistent with the segregation model contemplated elsewhere in the proposed instrument. By way of comparison, under the LSOC model in the US, a clearing agency is only required to ascribe a value of collateral attributable to each customer, not identify the type(s) of collateral attributable to each customer. Recording this level of detail could also be misinterpreted by customers to mean that specific items of collateral are individually segregated for their benefit, whereas the commingling of customer collateral which is contemplated does not completely eliminate fellow customer risk. Indeed, as acknowledged in section 32 of the Proposed CP, the pooling of customer collateral and pro rata sharing of customer collateral cannot be avoided under certain bankruptcy and insolvency laws.

In light of the above, we would ask the CSA to reconsider the requirements in section 37(2)(b) of Proposed NI 94-102 on the basis the segregation model contemplated elsewhere in the instrument should only require the recording of collateral value. Assuming the CSA agrees, we would ask that section 30(1) of the Proposed CP be amended to clarify that the record-keeping obligation with respect to collateral means collateral value only. We would also ask that section 44(b) (customer collateral reports) be amended to remove the references to "asset type and quantity of customer collateral" (again on the basis that "current value" should be sufficient).

Books and Records – Separate Records of Customer Positions and Collateral Value

Sections 38(b) and (c) of Proposed NI 94-102 require a regulated clearing agency to keep separate books and records that, at any time, enable it and each of its direct intermediaries to distinguish in the accounts held at the regulated clearing agency: " (b) the positions and value of customer collateral held for or on behalf of the direct intermediary's customers; and (c) the positions and value of customer collateral held for or on behalf of customers of each indirect intermediary for which the direct intermediary provides clearing services." CME Group notes that the US regime only requires a DCO to record the value of customer collateral held in satisfaction of DCO margin requirements, but not excess collateral posted by the customer as would appear to be required under Section 38(b). We respectfully request the CSA reconsider whether Section 38(b) should apply against non-Canadian clearing agencies such as those in the U.S., which are subject to different regulatory requirements and which have built operational systems accordingly. Further, CME Group requests that the CSA revise Section 38(b) to clarify that clearing agencies are not required to distinguish the value of customer collateral on an individually segregated basis (i.e., it can be recorded within an omnibus customer account)

With respect to Section 38(c), we would note that the types of indirect clearing arrangements for OTC derivatives contemplated by this provision are not (to our knowledge) currently available although we recognize they may be offered in the future. To the extent they are made available in the future, we would note that the CFTC has stated it intends, to the extent the indirect intermediary is not a US entity, to treat such indirect intermediary's accounts as a single customer for purposes of applying segregation requirements for OTC cleared swaps (although the CFTC recognizes further segregation may be required under applicable foreign laws). To align with the CFTC approach in this regard, we would ask the CSA to provide that Sections 38(b) and (c) only apply to a non-Canadian direct intermediary or indirect intermediary to the extent such intermediary is required to provide that level of protection under applicable foreign laws. We would also ask the CSA to clarify that Sections 38(b) and (c) only apply to a direct intermediary or indirect intermediary in respect of their Canadian local customers (and not all of their customers).

Disclosure

In the case of CME Group, much of the information which is required to be disclosed under section 41 of Proposed NI 94-102 is available on our public website (including our rules, policies and procedures as well as CME's PFMI disclosure document). Pursuant to Part 39.37 of the CFTC's rules, CME Clearing is required to make public disclosure as a systemically important derivatives clearing organization ("SIDCO"), including "rules, policies, and procedures concerning segregation and portability of customers' positions and funds", including whether cleared swaps customer collateral is "(i) protected on an individual or omnibus basis or (ii) subject to any constraints, including any legal or operational constraints that may impair the ability of [CME] to segregate or transfer the positions and related collateral of [its] customers".

Rule changes must be filed with the CFTC and disseminated. For this purpose, "rule" is defined broadly and includes "any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, advisory, terms and conditions, trading protocol, agreement or instrument corresponding thereto, including those that authorize a response or establish standards for responding to a specific emergency, and any amendment or addition thereto or repeal thereof, made or issued by a registered entity or by the governing board thereof or any committee thereof, in whatever form adopted." While some rules may be self-certified, material changes to how CME Clearing operates are subject to an advance notice period as CME Clearing is a SIDCO. The filings are disclosed on our website and through various advisories.

For CME Group and similarly situated clearing agencies subject to US rules, we would request that substitute compliance be available to permit reliance on the existing disclosures to satisfy the requirements proposed in section 41 of Proposed NI 94-102. We would also ask that regulated clearing agencies which have previously made these disclosures available to existing local Canadian customers (either directly or through clearing intermediaries) not be required to make the same disclosures again (or notify customers that such information is available on a website) upon the coming into force of the new national instrument.

Reporting to Canadian Regulators

While CME Group fully supports increased transparency for regulators, we request that to the extent possible the reporting obligations be designed and implemented in a way that minimizes costly and duplicative reporting requirements for foreign clearing agencies and other providers of clearing services. In the case of CME Clearing, we already report information to certain Canadian securities regulatory authorities as a condition to existing exemptive relief from local recognition requirements. In addition, information regarding OTC derivatives (including cleared OTC derivatives) is currently reported to trade repositories pursuant to derivatives trading reporting requirements in effect in Ontario, Quebec and Manitoba. Similar reporting requirements will go live in the remaining jurisdictions in Canada in July 2016. In light of these existing reporting requirements and the information already available to regulatory authorities in Canada regarding cleared derivatives, we would ask the CSA to reconsider imposing additional reporting obligations on CME and similarly situated foreign clearing agencies under Proposed NI 94-102.

A significant portion of the information that clearing intermediaries would have to disclose pursuant to Form 94-102F3 is not currently reported by CME to other regulatory authorities. For example, we do not currently report (i) the maximum value of customer collateral posted to CME during reporting periods (column 3 under "Customer collateral" in Table A of Form 94-102F3) or (ii) the average value of customer collateral posted to CME over a reporting period (column 4 under "Customer collateral" in Table A of Form 94-102F3). Also, we do not report collateral values by location as contemplated in Table B of Form 94-102F3. Given the significant burden involved in developing separate reporting just for Canadian customers, we would ask the CSA to reconsider these parts of Proposed NI 94-102. With respect to the remaining information contemplated in Table A of Form 94-102F3, we believe it would be appropriate for CME to report customer collateral information for customer positions of our Canadian clearing intermediary members. We do not believe it would be appropriate to require reporting for every clearing member of CME. We have no means to differentiate in our reporting between Canadian and non-Canadian customers and, given the relatively small proportion of our business which involves Canadian local customers, it is unclear how the aggregate collateral holdings of our non-Canadian clearing members would assist the CSA in fulfilling their monitoring functions. For these reasons, we would ask the CSA to reconsider the reporting obligations of clearing agencies and, at a minimum, limit the reporting obligation to information related to collateral held by Canadian intermediaries. To the extent the CSA would like to receive additional information, we believe that the best source for such information would be clearing members as opposed to requiring customer level reporting by regulated clearing agencies.

Portability and Transferability

CME Group agrees with the CSA regarding the importance of being able to transfer customer positions and collateral in certain pre-default and post-default scenarios. CME Group also appreciates the fact the CSA have recognized in the Proposed CP some of the difficulties and challenges in ensuring transfer and portability arrangements work as intended in all circumstances. On that basis, CME Group would ask that the obligation in section 46(1) recognize more explicitly the issues and challenges discussed in the

Proposed CP (perhaps by substituting the words “must facilitate” with “must facilitate to the extent practicable” or words to similar effect). We also suggest that the CSA amend section 46(3)(a) to reflect the fact that customer consent to transfer will not always be obtained. In lieu of explicit customer consent, certain default scenarios rely on negative consent (in connection with auction procedures, for example). Also, as acknowledged in the Proposed CP, the ability to transfer positions and collateral without client consent may actually be explicitly set out in the policies or procedures of the regulated clearing agency. On this basis, in order not to create any doubt about when transfers are permitted, we support amending section 46(3)(a) along the lines suggested above.

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CME Group appreciates the opportunity to submit feedback to the CSA on Proposed NI 94-102. Please feel free to contact the undersigned via email at sunil.cutinho@cmegroup.com or Maureen Guilfoile at maureen.guilfoile@cmegroup.com if you have any questions.

Yours sincerely,

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