



BY EMAIL ONLY

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**RE: Proposed NI 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions**

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Dear Sirs/Mesdames:

TMX Group Limited ("TMX Group") appreciates the opportunity to comment on Proposed NI 94-102 Derivatives: Customer Clearing and Protection of Customer Collateral and Positions ("NI 94-102" or "Proposed Rule"). In line with the representations that were made to the regulators with respect to Notice 91-304 Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral and Positions, TMX Group believes that the regulators should apply an approach to the Proposed Rule that is consistent with foreign jurisdictions and which will be applied consistently across provincial jurisdictions. Such approach is necessary to ensure a global and national level playing field for entities based in different

jurisdictions. Specifically, TMX Group would like to take this opportunity to comment on a few additional drafting points which would provide helpful clarity.

## TMX Group

TMX Group's key subsidiaries operate cash and derivatives markets for multiple asset classes, including equities, fixed income and energy. The Canadian Derivatives Clearing Corporation ("CDCC"), a subsidiary of TMX Group, offers central clearing counterparty services for both exchange-traded derivatives ("ETDs") products and a range of customized financial instruments (OTC cleared), including options on single-name equities and exchange-traded funds ("ETFs").

## GENERAL COMMENTS

TMX is supportive of a domestic regime for customer protection that is consistent with the international regulation and which follows a coherent and realistic implementation timeline across the different markets. TMX Group is cognizant of the importance to offer enhanced customer protection in line with the Principles for Financial Market Infrastructures ("PFMIs" or the "Principles") published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions ("CPMI-IOSCO"). However, in line with the primary objectives of the PFMIs which are to promote the safety and efficiency of the FMIs, TMX Group calls on its regulator to ensure that the proposed changes are required to achieve such objectives and provide for minimal impact to the legal, technological and operational infrastructures of all of the CCPs' stakeholders. In addition, TMX Group would like to have clarifications as to the scope of NI 94-102.

## SCOPE OF THE INSTRUMENT

### i. Products

NI 94-102 defines the term Cleared Derivative as "a transaction in a derivative that is, directly or indirectly, submitted to and cleared by a clearing agency". This implies that all derivatives, including ETDs, are covered by the definition contrary to the scope of the instrument. Indeed, subsection 2(2) specifies that the Instrument extends only to derivatives covered by Rule or Regulation 91-506 or 91-101- on Product Determination, which means "derivatives that are not traded on an exchange and to derivatives that are traded on a derivatives trading facility<sup>1</sup>. For consistency, and to ensure that the scope of the instrument does not span beyond its intended objective, we suggest that the term "Cleared Derivatives" should be directly tied to the derivatives covered by Rule/Regulation 91 506/91-101, accordingly.

In line with the above comment, we would like to have clarifications as to the intended scope of the Proposed Rule as it relates to the clearing agency. As it currently stand, and contrary to subsection 2(1)(b) and (c), it appears that NI 94-102 is applicable at the clearing agency level for all cleared derivatives, including ETDs for those clearing agencies that offer both ETDs and non-ETDs clearing services. For consistency, we recommend that section 2(1)(a), similarly to subsections 2(1) (b) and (c), specifies that the requirements apply to regulated clearing agencies as it relates to the derivatives covered by the NI.

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<sup>1</sup> Quebec Regulation 91-506 respecting derivatives determination, Derivatives Act.

## **ii. Account Structure**

We note that Section 30 with respect to the holding of customer collateral by a regulated clearing agency permits the use of “one or more accounts” without clarifying in what circumstances a single account instead of several accounts should be used. In addition, in the absence of the use of the term “segregate” or “commingle”, the standard set under Section 30 appears unclear. We note that the Companion Policy indicates that “the customer collateral of multiple customers may be commingled in an omnibus customer account” while individually identifying the collateral with the position, we purport that the rule should explicitly permit commingling and the use of an omnibus account for further clarity.

Section 30 (2) requires a clearing agency to hold customer collateral of each customer separately from all other properties of such customer that is not customer collateral. Unless the rule contemplates that the clearing agency must offer individually separate accounts, which would contradict with the CP, the language found under Section 30(2) may be misleading. In addition, considering the definition of “Customer Collateral” which would include Variation Margin, the standard of segregation would require a clearing agency to hold a separate bank account for such portion of a collateral, a significant change from the current practice. Furthermore, considering the definition of “Customer and Customer Collateral”, and Section 2 (1), it is unclear if a Clearing Agency is required to hold a separate account for Customer Collateral stemming from the derivatives covered by the instrument as per Section 2(2) and a distinct one for collateral required to support ETDs that such a customer may hold.

### **STANDARD OF PROTECTION**

#### **i. Beneficiary of Protection**

The definition of “Customer” under the Proposed Rule points to the end-user or ultimate counterparty to the derivatives, implying the beneficial owner of the position. We do not see the benefits of expanding the scope of this rule in this way. We submit that the rule cannot extend to the ultimate end user but should be limited to the clearing agency participant’s (the direct intermediary) customer. Section 38 (c) requires a clearing agency to hold information on the indirect intermediary’s customers. While, in addition to segregation and proper margin level, holding customer information is meant to increase the likelihood of portability. However, in practical terms, a clearing agency is unlikely to succeed in porting a customer position and associated collateral if it has to protect the customer several layers down the intermediary ladder.

#### **ii. Portability Provisions**

Section 46 requires the porting of a customer account if the customer’s account is not currently in default. The clearing agency rules do not govern the relationship between the clearing agency participant and its direct client and in a principal model, there is no privity of contract between the clearing agency and the customer, therefore the clearing agency will not be in a position to assess if the customer has defaulted from its obligation.

#### **iii. Variation Margin**

Section 28 requires a clearing agency to collect gross Margin. The CP indicates that the “regulated clearing agency may not, and may not permit its direct intermediaries to offset initial margin positions of different customers against one another”. The clearing agency’s rules do not prescribe the level of margin that a participant must request from its own customers. The absence of a contractual relationship with the customer would, in fact, make it impossible for a clearing agency to monitor or enforce such requirement.

## TREATMENT OF THE OPTION MARKET

In addition to the requested clarifications, we note that the proposed NI 94-102 extends the segregation and portability regime to the options market. While portability may be very desirable to the OTC Options market, especially as it relates to equity, given the predominance of institutional clients, we question the need for the level of segregation underlying the regime. Options, which are often assimilated to securities in many foreign jurisdictions, have a specific margining process and are treated on a gross basis. Indeed, long positions in Options do not require Initial Margin whereas Short positions do. As a result, there can be no netting of opposite positions and resulting margin, thus Initial Margin is collected on a gross basis. This in itself should ensure a margin level sufficient to permit portability. TMX Group is of the view that the level of segregation required under NI 94-102 will adversely limit the margin efficiency that the institutional investors are looking for when using OTC Options in parallel with ETD Options, especially as it relates to the Options Equity Market and will impose a significant burden on Equity Options market participants with no additional benefits.

Options, especially Equity Options under the US regulations, are not subject to the LSOC regime, which only applies to Swaps; whereas in Europe, no specific regime is imposed for Options. TMX Group purports that the level of customer protection prescribed under NI 94-102 as it relates to cleared derivatives other than swaps is unjustified and inconsistent with the global approach, thus setting the standards of customer protection for Canadian clearing agencies unnecessarily high for a market that is not elsewhere considered to be a particularly risky market.

## TIMELINE OF IMPLEMENTATION AND IMPACT ON THE CANADIAN OTC MARKET

In the absence of a similar customer protection regime currently in place for the Canadian ETD markets, TMX Group stresses the need for a realistic implementation timeline for NI 94-102. The Proposed Rule, as it currently stands, will imply significant technological, operational and rule changes for clearing agencies and will require significant investment which may adversely affect the Non-ETD clearing value proposition.

TMX Group appreciates the opportunity to provide comments with respect to the Proposed Rule and looks forward to further dialogue on protection of customer collateral and position. We hope that you will consider our concerns and suggestions and would be happy to discuss at greater length. Please feel free to contact Marlene Charron-Geadah, Legal Counsel Derivatives at [MCharron-Geadah@m-x.ca](mailto:MCharron-Geadah@m-x.ca).

Respectfully submitted,



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