

## CSA Staff Notice 24-315

*Update on Enhanced Segregation and Portability Initiatives for  
Clearing Agencies Serving the Domestic Futures Markets*

February 9, 2017

The Canadian Securities Administrators (CSA) recently published advanced notice of the adoption of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* and related Companion Policy (collectively, **NI 94-102**). NI 94-102 implements a segregation and portability regime to protect customer collateral and positions in the over-the-counter (OTC) derivatives markets.<sup>1</sup> In light of this development, CSA Staff (**Staff** or **we**) are publishing this Notice to provide an update on initiatives to enhance segregation and portability arrangements for the exchange-traded derivatives (ETD) markets in Canada, in particular the commodity and financial futures markets.<sup>2</sup>

## Background

National Instrument 24-102 *Clearing Agency Requirements (Instrument)* and Companion Policy 24-102 *Clearing Agency Requirements (Companion Policy)* (collectively, **NI 24-102**) include ongoing requirements for recognized clearing agencies that are based on international standards applicable to financial market infrastructures operating as a central counterparty (CCP), central securities depository or securities settlement system. These international standards are described in the April 2012 report *Principles for financial market infrastructures* (the **PFMI Principles**) published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions.<sup>3</sup>

Part 3 of the Instrument requires a recognized clearing agency to establish, implement and maintain rules, procedures, policies or operations designed to ensure it meets or exceeds the relevant PFMI Principles, including Principle 14 *Segregation and portability* for a clearing agency that operates as a CCP.

Principle 14 states that a CCP should have rules and procedures that enable the segregation and portability of positions of a clearing participant's customers and the collateral provided to the CCP with respect to those positions. The purpose of such segregation and portability arrangements is to protect a clearing participant's customers' positions and related collateral from the default or insolvency of that participant.

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<sup>1</sup> See CSA Notice of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* and Related Companion Policy, January 19, 2017, (2017), 40 OSCB 672.

<sup>2</sup> This Staff Notice does not create any new regulatory requirements or suggest any specific change at this time in any existing legal or regulatory obligations; nor does it provide relief from any existing regulatory obligations.

<sup>3</sup> The report is available on the Bank for International Settlements' website ([www.bis.org](http://www.bis.org)) and the IOSCO website ([www.iosco.org](http://www.iosco.org)).

## Industry engagement

In the notice of approval of NI 24-102 on December 3, 2015,<sup>4</sup> we said that Staff were continuing to review the implications of enhanced CCP-level customer segregation and portability rules and procedures for CCPs serving the ETD markets, particularly on investment dealers, the customer protection regime of the Investment Industry Regulatory Organization of Canada (**IIROC**) and Canadian Investor Protection Fund (**CIPF**), and the pro rata distribution scheme of Part XII of the *Bankruptcy and Insolvency Act* (Canada) (**BIA**).<sup>5</sup>

We have engaged extensively with industry stakeholders since 2015 on the question of what is the appropriate CCP segregation and portability model for domestic futures markets. Among other dialogues, we held a two-day workshop in November 2015 in Toronto with representatives of IIROC, CIPF, certain CCPs, dealer firms, buy-side firms, legal experts, and other key stakeholders.

Stakeholders generally support enhancing segregation and portability arrangements and agree that a gross-customer margin (**GCM**) model offers superior customer protection and is appropriate for the Canadian Derivatives Clearing Corporation (**CDCC**) and ICE Clear Canada Inc. (**ICE Clear**).<sup>6</sup> Collecting margin on a gross basis means that the amount of margin that a clearing member must post to the CCP on behalf of its customers is the sum of the amounts of margin required for each such customer.<sup>7</sup> Generally, under a GCM framework, a CCP collecting gross margin on futures positions held in dealer omnibus customer accounts requires clearing members to submit individual customer level position data daily to the CCP.

## GCM model favours customer protection

We agree that the GCM model offers superior customer protection when compared to collecting margin on a net basis. There are compelling reasons to ensure that the collateral posted by a futures customer to a dealer – which in turn is posted (or the value of which is posted) by the dealer to a CCP – receives the strong protections available from a GCM model. It will enhance customer protection, especially by strengthening the ability to port customer positions and collateral in the event of a clearing participant default. It may also reduce systemic risk, by bolstering confidence that losses related to counterparty risk would be manageable. ICE Clear

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<sup>4</sup> See CSA Notice of Approval of National Instrument 24-102 *Clearing Agency Requirements* and Companion Policy 24-102CP to National Instrument 24-102 *Clearing Agency Requirements*, December 3, 2015 (2015), 38 OSCB (Supp-5) (**2015 Notice**).

<sup>5</sup> See 2015 Notice, at p. 7. For a discussion of segregation and portability arrangements for CCPs serving the cash markets, see section 3.3 of the Companion Policy, which includes a description of the “IIROC-CIPF regime”.

<sup>6</sup> CDCC and ICE Clear are the two CCPs that clear trades in domestic futures products for clearing members and their customers. While Natural Gas Exchange Inc. also services domestic futures markets, it does not operate under a customer clearing model.

<sup>7</sup> This is in contrast to a net customer omnibus margining model, where the CCP will net customer positions against each other to determine overall customer collateral required by the CCP from the clearing participant to support the customer positions in the clearing participant’s customer omnibus account. A net margining methodology exposes customers to greater “fellow customer risk”.

has implemented a GCM segregation and portability framework<sup>8</sup> and CDCC is working to develop and implement such a framework.<sup>9</sup>

However, we recognize that the GCM model has implications on the current IIROC-CIPF regime and may require changes to certain IIROC dealer member rules on segregation, capital and margin, and, potentially, to the coverage scheme provided by CIPF. Since February 2016, staff from the CSA, IIROC, CIPF, CDCC and ICE Clear (collectively, the **SP Working Group**) have been meeting regularly to discuss the GCM model for domestic futures markets, including understanding the details of the CCP porting mechanisms in the context of the IIROC-CIPF regime, and identifying any consequential reforms to the IIROC-CIPF regime and provincial securities, derivatives or commodity futures legislation that may be required.<sup>10</sup>

### **NI 24-102 approach to implementing segregation and portability**

We do not believe that changes to NI 24-102 are necessary at this time to prescribe a CCP GCM model. Part 3 of the Instrument applies a principles-based approach to applying the PFMI Principles, and mandating a particular GCM segregation and portability framework in NI 24-102 would be inconsistent with such approach.<sup>11</sup> At this time, we believe that Principle 14, together with its key considerations and explanatory notes, gives sufficient guidance to CCPs in the Canadian context.<sup>12</sup>

### **Next steps**

The SP Working Group will continue to meet regularly during 2017. Any proposed new or amended IIROC or CDCC rules would be subject to a public comment process and regulatory approval by certain CSA members.

Questions with respect to this Notice may be referred to:

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<sup>8</sup> See ICE Clear's PFMI Disclosure Framework Document dated November 15, 2016 at: [https://www.theice.com/publicdocs/clear\\_canada/Clear\\_Canada\\_Disclosure\\_Framework.pdf](https://www.theice.com/publicdocs/clear_canada/Clear_Canada_Disclosure_Framework.pdf). (see section 1.1 of the Instrument for a definition of "PFMI Disclosure Framework Document").

<sup>9</sup> See CDCC's PFMI Disclosure Framework Document (information provided as of December 31, 2016) at: [http://www.cdcc.ca/cdcc\\_qld/CDCC\\_Qualitative\\_Disclosure\\_20161231.pdf](http://www.cdcc.ca/cdcc_qld/CDCC_Qualitative_Disclosure_20161231.pdf).

<sup>10</sup> While the SP Working Group has preliminarily identified a number of IIROC rules for reform, it remains unclear at this time whether and how CIPF coverage for futures customers should be modified, or whether any rules under Part XII of the BIA may need to be amended. In addition, with implementation of a GCM framework, the SP Working Group has preliminarily identified the potential need to amend standard written risk disclosure statements that are currently prescribed by provincial securities, derivatives or commodity futures legislation and required to be provided by a dealer to a customer when opening a futures account.

<sup>11</sup> This view is similar to the approach adopted by the U.S. Securities and Exchange Commission (SEC) in implementing PFMI Principle 14 in connection with the clearing by CCPs of security-based swaps. See the SEC's final adopted Rule 17AD-22(e)(14): *Segregation and Portability*; 17 CFR Part 240 in Release No. 34-78961; File No. S7-03-14, *Standards for Covered Clearing Agencies*, September 28, 2016.

<sup>12</sup> However, it is possible that broader regulatory reforms to the ETD markets may be considered in the long term, including taking an approach similar to the customer protection and segregation and portability regime in NI 94-102 for the OTC derivatives markets. Among other considerations, the so-called "futurization" of OTC derivatives may provide policy reasons for eventually harmonizing regulatory approaches to the ETD and OTC markets, particularly to reduce regulatory gaps among the markets.

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