

## CSA Notice 91-304

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

**January 16, 2014**

**Introduction**

We, the Canadian Securities Administrators OTC Derivatives Committee (the “Committee”) are publishing for comment period expiring on March 19, 2014:

- Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (the “Customer Clearing Rule” or “Rule”), and
- Model Explanatory Guidance to Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (the “Customer Clearing EG”).

Collectively the Customer Clearing Rule and the Customer Clearing EG will be referred to as the “Model Rule”.

We are issuing this notice to provide interim guidance and solicit comments on the Model Rule. Once we have considered comments received on the Model Rule and made appropriate changes, each jurisdiction will publish its own rule, explanatory guidance and forms, with necessary local modifications.<sup>1</sup>

The Committee would also like to draw your attention to a recent publication by certain members of the Canadian Securities Administrators of proposed rules for clearing agencies requirements<sup>2</sup> and CSA Staff Notice 91-303 - Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives. These publications, including the Model Rule, all relate to central counterparty clearing and we therefore invite the public to consider these comprehensively.

**Background**

In order to implement the G-20 commitments<sup>3</sup> that relate to the regulation of the trading of derivatives in Canada, the Committee has been working on recommendations both independently and in collaboration with the Canadian OTC Derivatives Working Group.<sup>4</sup> Since November 2010, the Committee has published a series of derivatives consultation papers outlining policy

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<sup>1</sup> In some cases, jurisdictions with substantively similar securities legislation may consider developing and publishing multi-lateral instruments.

<sup>2</sup> See OSC Rule 24-503 Clearing Agency Requirements available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca)

<sup>3</sup> The G-20 commitments include requirements that all standardized over-the-counter derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. Moreover, over-the-counter derivative contracts should be reported to trade repositories. Also, non-centrally cleared contracts should be subject to higher capital requirements.

<sup>4</sup> The Canadian OTC Derivatives Working Group consists of the Bank of Canada, the federal Department of Finance, the Office of the Superintendent of Financial Institutions, the Alberta Securities Commission, the Autorité des marchés financiers, the British Columbia Securities Commission and the Ontario Securities Commission.

recommendations for the regulation of derivatives in Canada.<sup>5</sup> In formulating these recommendations, the Committee has sought to strike a balance between proposing regulation that does not unduly burden participants in the derivatives market, while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities.

The regulatory framework will be implemented through provincial rules that are intended to impose specific regulatory requirements tailored to address the unique characteristics of derivatives products, how they are marketed and traded, the sophistication of the counterparties and existing regulation in other areas (such as the regulation of financial institutions). To the greatest extent appropriate, the derivatives rules will be harmonized with international standards and be consistent across Canada.

### **Rule-making process**

Continuing the process initiated for Rule 91-506 *Derivatives: Product Determination* and Rule 91-507 *Trade Repositories and Derivatives Data Reporting*, the Committee's rule-making process involves the publication for comment of "model" rules covering a variety of areas of regulation that together will create a regime for the regulation of derivatives markets. The "model" rules will reflect the public commentary on the consultation papers and are the Committee's recommendations for specific proposals to regulate the derivatives market in Canada. Due to variations in provincial securities legislation, the final provincial rules will contain differences. However, it is the intention of the Committee that the substance of the rules will be the same across jurisdictions, and market participants and derivative products will receive the same treatment across Canada.

Each of the "model" rules will be published for a consultation period after which the Committee will evaluate comments received and recommend appropriate amendments to the model rule. Once this process is completed, each province will publish province-specific proposed rules for comment in accordance with the legislative requirements of the province. In a number of provinces legislative amendments will need to be implemented before province-specific rules can be published for consultation. Because of this, publication dates of province-specific rules may vary. Once each province's comment period has been completed, final rules will be implemented by that province.

### **Substance and purpose of the Customer Clearing Rule**

Canadian and international initiatives promoting the clearing of over-the-counter ("OTC") derivative transactions will cause certain market participants, who are not clearing members at a derivatives clearing agency, to clear their OTC derivatives transactions indirectly through market participants that are clearing members or otherwise provide clearing services. The purpose of the Customer Clearing Rule is to ensure that customer clearing is done in a manner that protects customer collateral and positions and improves derivatives clearing agencies' resilience to a clearing member default. For a more detailed explanation of customer clearing please see CSA

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<sup>5</sup> 91-401 *Over-the-Counter Derivatives Regulation in Canada*, 91-402 *Derivatives: Trade Repositories*, 91-403 *Derivatives: Surveillance and Enforcement*, 91-404 *Segregation and Portability in OTC Derivatives Clearing*, 91-405 *Derivatives: End User Exemption*, 91-406 *Derivatives: OTC Central Counterparty Clearing* and 91-407 *Derivatives: Registration*.

Consultation Paper 91-404 *Derivatives: Segregation and Portability in OTC Derivatives Clearing*.<sup>6</sup>

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

#### **Application of Rule 91-506 *Derivatives: Product Determination***

We intend that Rule 91-506 *Derivatives: Product Determination* will be applicable to the Customer Clearing Rule. Therefore, any product which falls within the scope of Rule 91-506 and is cleared on behalf of a customer would be subject to the Customer Clearing Rule.

#### **Comments**

We request your comments on all aspects of the Model Rule. The Committee also seeks specific feedback on the following questions:

1. Should excess customer collateral be permitted to be held by clearing members and clearing intermediaries? Some jurisdictions believe that all collateral including excess collateral should flow directly to and be held at a derivatives clearing agency.
2. If all customer collateral was required to be held at a derivatives clearing agency should additional requirements for the holding of excess customer collateral be applied to derivatives clearing agencies?
3. What specific role is it anticipated that a clearing intermediary will play in the context of clearing OTC derivatives and are the obligations on clearing intermediaries appropriate?
4. Should a customer's cleared derivatives collateral held at the clearing member or clearing intermediary level be permitted to be commingled with other collateral of that customer such as collateral for futures transactions?

You may provide written comments in hard copy or electronic form. The comment period expires March 19, 2014.

The Committee will publish all responses received on the websites of the Autorité des marchés financiers ([www.lautorite.qc.ca](http://www.lautorite.qc.ca)) and the Ontario Securities Commission ([www.osc.gov.on.ca](http://www.osc.gov.on.ca)).

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<sup>6</sup> Available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

Please address your comments to each of the following:

Alberta Securities Commission  
Autorité des marchés financiers  
British Columbia Securities Commission  
Manitoba Securities Commission  
Financial and Consumer Services Commission (New Brunswick)  
Nova Scotia Securities Commission  
Ontario Securities Commission

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

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario  
M5H 3S8  
Fax: 416-593-2318  
[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

Anne-Marie Beaudoin,  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, Tour de la Bourse  
Montréal, Québec  
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Fax : 514-864-6381  
[consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

## Questions

Please refer your questions to any of:

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**MODEL PROVINCIAL RULE**  
**DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER**  
**COLLATERAL AND POSITIONS**

**PART 1**  
**DEFINITIONS**

**Definitions**

**1. In this Rule**

“cleared derivative” means a transaction that is cleared by a derivatives clearing agency;

“clearing intermediary” means a person or company that provides clearing services to a customer in respect of a cleared derivative by intermediating the relationship between the customer and a clearing member;

“clearing member” means a person or company that has entered into a membership agreement with, and thereby agrees to be bound by the rules and procedures of, a derivatives clearing agency;

“customer” means a party to a cleared derivative from whom or on whose behalf a derivatives clearing agency, clearing member or clearing intermediary has received or holds property with respect to the cleared derivative if, at the time of the transaction, the party, the derivatives clearing agency, the clearing member or the clearing intermediary is:

- (i) a person or company organized under the laws of [Province X];
- (ii) a person or company that has its head office or principal place of business in [Province X]; or
- (iii) an individual that resides in [Province X].

“customer account” means an account maintained by a clearing member, a clearing intermediary or derivatives clearing agency for or on behalf of one or more customers that records customer positions in cleared derivatives and holds the related customer collateral;

“customer collateral” means all property received or held by a clearing member, clearing intermediary or derivatives clearing agency from or on behalf of a customer, that is intended to or does margin, guarantee, secure, settle or adjust a cleared derivative, and includes initial margin, variation margin and excess margin;

“derivatives clearing agency” means a person or company described in paragraph (b) of the definition of “clearing agency” in [subsection 1(1)<sup>1</sup> of the Act] and recognized under [section 21.2 of the Act] or exempt from the recognition requirement under [section 147 of the Act];

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<sup>1</sup> Ontario *Securities Act*, s.1(1) “clearing agency” means, (b) with respect to derivatives, a person or company that provides centralized facilities for the clearing and settlement of trades in derivatives that, with respect to a contract, instrument or transaction,

(i) enables each party to the contract, instrument or transaction to substitute, through novation or otherwise, the credit of the clearing agency for the credit of the parties,

(ii) arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such contracts, instruments or transactions executed by participants in the clearing agency, or

“excess margin” means the customer collateral required by a clearing member or clearing intermediary in excess of the amount required by the derivatives clearing agency for the cleared derivatives of a customer;

“initial margin” in relation to a derivatives clearing agency’s margin system to manage credit exposures to its participants, means collateral that is required by the derivatives clearing agency to cover potential changes in the value of each customer’s position (that is, potential future exposure) over an appropriate close-out period in the event of default;

“permitted depository” means any of the following:

- (a) a bank listed in Schedule I, II or III to the Bank Act (Canada);
- (b) a company to which the Trust and Loan Companies Act (Canada) applies;
- (c) a loan corporation or trust corporation registered under the Loan and Trust Corporations Act (Ontario) or a similar statute of a jurisdiction of Canada (other than Ontario);
- (d) a financial services cooperative within the meaning of the Act respecting financial services cooperatives (Quebec);
- (e) a clearing agency recognized under **[section 21.2 of the Act]** or exempt from the recognition requirement under **[section 147 of the Act]**;
- (f) a foreign entity that carries on business similar to the entities listed in paragraph (a), (b) or (c), provided that the foreign entity is regulated in the foreign entity’s home jurisdiction in a similar manner to the entities listed in paragraph (a), (b) or (c);

“permitted investment” means cash or highly liquid financial instruments with minimal market and credit risk that are capable of being liquidated rapidly with minimal adverse price effect;

“transaction” means entering into, assigning, selling or otherwise acquiring or disposing of a derivative or the novation of a derivative, other than a novation resulting from the submission of a derivative to a derivatives clearing agency;

“variation margin” in relation to a derivatives clearing agency’s margin system to manage credit exposures for all products it clears, means funds that are collected and paid out on a regular and *ad hoc* basis to reflect current exposures resulting from actual changes in market prices.

(2) Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination* applies to this Rule.

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(iii) otherwise provides clearing services or arrangements that mutualize or transfer among participants in the clearing agency the credit risk arising from such contracts, instruments or transactions executed by the participants,

but does not include a person or company solely because the person or company arranges or provides for,

(iv) settlement, netting or novation of obligations resulting from agreements, contracts or transactions on a bilateral basis and without a central counterparty,

(v) settlement or netting of cash payments through the Automated Clearing Settlement System or the Large Value Transfer System, or

(vi) settlement, netting or novation of obligations resulting from a sale of a commodity in a transaction in the spot market.

## **PART 2**

### **TREATMENT OF CUSTOMER COLLATERAL**

#### **Collection of initial margin**

2. (1) A derivatives clearing agency must collect initial margin for each customer of its clearing members on a gross basis.
- (2) A clearing member must collect initial margin for each cleared derivative of a customer, including each customer of a clearing intermediary, in an amount that is no less than the initial margin requirement imposed by the relevant derivatives clearing agency.

#### **Segregation of customer collateral**

3. (1) A derivatives clearing agency, clearing member and clearing intermediary must keep customer collateral segregated from its own property.
- (2) Subject to the requirements in Part 3, a derivatives clearing agency, clearing member and clearing intermediary may commingle customer collateral received from or on behalf of multiple customers but must not otherwise commingle customer collateral with the property of any other person or company.
- (3) A derivatives clearing agency must not commingle customer collateral of a particular customer with any other property of that customer that is not customer collateral.

#### **Holding of customer collateral**

4. (1) A derivatives clearing agency, clearing member and clearing intermediary must hold customer collateral either directly or through one or more customer accounts at a permitted depository.
- (2) If a derivatives clearing agency, clearing member or clearing intermediary holds customer collateral directly, it must provide reasonable protection for the customer collateral.
- (3) If a derivatives clearing agency, clearing member or clearing intermediary holds customer collateral at a permitted depository, it must
  - (a) maintain one or more customer accounts with the permitted depository;
  - (b) ensure that the customer account clearly identifies the name of each customer or otherwise shows that the customer account is segregated for and on behalf of one or more customers and indicates that the property in the account is customer collateral; and
  - (c) ensure that the permitted depository treats all property in the customer account as customer collateral.



### **Excess margin**

5. A derivatives clearing agency, clearing member and clearing intermediary must have rules, policies and procedures in place to record and identify, at least each business day, for each customer, the excess margin held by the derivatives clearing agency, clearing member and clearing intermediary.

### **Clearing member maintenance of customer account balance**

6. A clearing member must at all times maintain property in one or more customer accounts at the derivatives clearing agency that is at least equal to the total amount of collateral required by the derivatives clearing agency for the cleared derivatives of its customer(s).

### **Clearing member and clearing intermediary deposits in customer accounts**

7. (1) A clearing member or clearing intermediary may deposit its own property in a customer account.
- (2) Property deposited in a customer account under subsection (1) is deemed, for the purposes of this Rule, to be customer collateral.
- (3) A clearing member or clearing intermediary may withdraw property deposited by it under subsection (1) from a customer account only if it has reflected in its accounts and records immediately prior to the withdrawal the excess values set out in subsection 18(1) or subsection 19(1).

### **Use of customer collateral**

8. (1) A derivatives clearing agency, clearing member and clearing intermediary must not use or permit the use of customer collateral of a customer to:
  - (a) margin, guarantee, secure, settle or adjust cleared derivatives of a person or company other than the customer; or
  - (b) secure or extend the credit of a person or company other than the customer.
- (2) guarantee, secure, settle or adjust a trade of the customer that is not a cleared derivative.
- (3) A derivatives clearing agency, clearing member and clearing intermediary must not otherwise use or permit the use of customer collateral except in accordance with section 9.
- (4) A derivatives clearing agency, clearing member or clearing intermediary must not impose or permit the imposition of a lien or claim on a customer's positions or customer collateral, except a claim resulting from a cleared derivative in the customer account in favour of:
  - (a) the customer; or
  - (b) the clearing member, clearing intermediary or derivatives clearing agency responsible for clearing the cleared derivatives of the customer.

### **Investment of customer collateral**

9. (1) A derivatives clearing agency, clearing member and clearing intermediary may invest customer collateral only in a permitted investment.
- (2) A loss resulting from an investment made under subsection (1) must be borne solely by the investing derivatives clearing agency, clearing member or clearing intermediary.

### **Acting as a clearing intermediary**

10. (1) A clearing member may not provide clearing services to a clearing intermediary unless the clearing member and the derivatives clearing agency determine that the arrangement does not expose the derivatives clearing agency and the clearing member to material additional risk.
- (2) A clearing intermediary must open a segregated account with each clearing member for which it is an intermediary for the exclusive purpose of holding and recording the positions and customer collateral of its customers.
- (3) A clearing intermediary must provide each clearing member for which it is an intermediary with sufficient information to identify, monitor and manage any material risks arising from its clearing intermediary activity.

### **Risk management**

11. A derivatives clearing agency must identify, monitor and manage any material risks attributable to clearing members or clearing intermediaries which could affect the risk exposure of the derivatives clearing agency.

### **Same**

12. A clearing member that permits a person or company to act as a clearing intermediary must identify, monitor and manage material risks arising from permitting the person or company to act as a clearing intermediary.

### **Same**

13. No person or company may provide clearing services to a customer as a clearing member or clearing intermediary unless the person or company is prudentially regulated by an appropriate regulatory authority.

### **Clearing member default**

14. (1) A derivatives clearing agency must not apply customer collateral to satisfy the obligations of a clearing member of the derivatives clearing agency that arise as a consequence of the clearing member's default.
- (2) Despite subsection (1), a derivatives clearing agency may apply the customer collateral of a customer in full or partial satisfaction of a clearing member's obligations that arise as a consequence of the clearing member's default, to the extent that those obligations are attributable to the customer's obligations.

### **Clearing intermediary default**

15. (1) A clearing member that permits a person or company to act as a clearing intermediary must establish policies and procedures to manage the default of the clearing intermediary.

(2) Customer collateral must not be applied by a clearing member to satisfy the clearing intermediary's obligations.

## **PART 3 RECORD-KEEPING**

### **Retention of records**

16. A derivatives clearing agency, clearing member and clearing intermediary must keep the records required under Part 3 and Part 4, and all supporting documentation in a readily accessible location, for the life of the cleared derivative and for a further 7 years after the date on which the cleared derivative expires or terminates.

### **Books and records**

17. (1) A derivatives clearing agency, clearing member and clearing intermediary receiving customer collateral must, at least once each business day, calculate and record:

- (a) the amount of customer collateral it requires from each customer; and
- (b) the total amount of customer collateral it requires from all customers.

(2) A clearing member must separately calculate and record the collateral amounts referenced in subsection (1) with respect to the customers of each of its clearing intermediaries.

(3) A clearing member and clearing intermediary must calculate and record as of the close of each business day the total market value of all customer collateral in its customer accounts.

(4) A derivatives clearing agency, clearing member and clearing intermediary must reflect in the books and records it maintains for a customer the market value of any customer collateral that it receives from the customer, adjusted on a daily basis for:

- (a) any accruals on the customer collateral creditable to the customer;
- (b) any gains or losses in respect of the customer collateral;
- (c) any charges lawfully accruing to the customer;
- (d) any authorized distributions or transfers of the customer collateral; and
- (e) the name of each person or company holding the customer collateral.

**Same**

- 18.** (1) For each customer, a clearing member must reflect in its books and records
- (a) the total amount of customer collateral required for the cleared derivatives of the customer by each derivatives clearing agency; and
  - (b) the total sum of the required customer collateral amounts, including any excess or deficit.

**Same**

- 19.** (1) For each customer, a clearing intermediary must reflect in its books and records
- (a) the total amount of collateral required for the cleared derivatives of the customer by each clearing member through which the clearing intermediary clears; and
  - (b) the total sum of the required collateral amounts, including any excess or deficit.

**Separate records – Derivatives Clearing Agency**

**20.** A derivatives clearing agency shall keep separate books and records that, at any time and without delay, enable the derivatives clearing agency and each clearing member to distinguish in the accounts held with the derivatives clearing agency the positions and property held for the account of the clearing member and the positions and customer collateral held for the account of each customer, including each customer of a clearing intermediary.

**Separate records – clearing members and clearing intermediaries**

**21.** (1) A clearing member shall keep separate books and records that enable it to distinguish in its own accounts and in accounts held with the derivatives clearing agency the positions and property of the clearing member and the positions and customer collateral held for the account of each of its customers.

(2) A clearing member that permits a person or company to act as a clearing intermediary must keep separate books and records that, at any time and without delay, enable:

- (a) the clearing member to distinguish in its own accounts and in accounts held with the derivatives clearing agency the positions and customer collateral held for the account of each customer of the clearing member and the positions and customer collateral held for the account of each customer who clears through a clearing intermediary; and
- (b) each clearing intermediary to distinguish in accounts held with the clearing member and with the derivatives clearing agency the positions and property of the clearing intermediary and the positions and customer collateral held for the account of each customer of the clearing intermediary.

(3) A clearing intermediary must keep separate books and records that enable it to distinguish in its own accounts and in accounts held with each clearing member through which it provides clearing intermediary services its positions and property and the positions and customer collateral held for the account of each of its customers.

### **Records of customer collateral**

**22.** (1) A derivatives clearing agency, clearing member and clearing intermediary that holds customer collateral itself must keep records that

- (a) identify each location where it holds the customer collateral,
- (b) describe the customer collateral held at each such location,
- (c) identify the protections provided by each such location relevant to the customer collateral held at such location, and
- (d) confirm compliance with all applicable policies and procedures relating to holding of customer collateral.

(2) A derivatives clearing agency, clearing member and clearing intermediary that holds customer collateral in a permitted depository must

- (a) prior to depositing customer collateral in a permitted depository, obtain and retain a written acknowledgement from the relevant permitted depository that the deposited property will be treated as customer collateral, and
- (b) keep records identifying each permitted depository at which it holds customer collateral and the amount of customer collateral held by the permitted depository, reflected on a daily basis.

### **Records of investment of customer collateral**

**23.** (1) A derivatives clearing agency, clearing member and clearing intermediary that invests customer collateral must keep the following records:

- (a) the dates of the investments;
- (b) the names of the persons and companies through which the investments were made;
- (c) daily market valuations of the investments and related supporting documentation;
- (d) the descriptions of the instruments in which the investments were made;
- (e) the identities of the depositories or other places where the instruments are segregated;

- (f) the dates on which the investments are liquidated or otherwise disposed of; and
- (g) the names of the persons and companies liquidating or disposing of the investments.

### **Records of currency conversion**

**24.** A derivatives clearing agency, clearing member and clearing intermediary must keep a record of each conversion of customer collateral from one currency to another.

## **PART 4**

### **REPORTING AND DISCLOSURE**

#### **Disclosure to clearing members and customers**

**25.** (1) The following prior written disclosure must be provided by a derivatives clearing agency to all of its clearing members:

- (a) the derivatives clearing agency's rules, policies, and procedures that govern the segregation and use of customer collateral and the transfer or liquidation of a cleared derivative of a customer in the event of a default by the clearing member, and any changes to the rules, policies and procedures;
- (b) the impact of laws, including bankruptcy and insolvency laws, on the derivatives clearing agency's ability to fully segregate or transfer customer collateral; and
- (c) the circumstances under which the interest or ownership rights in the customer collateral may be enforced by the derivatives clearing agency or customer.

(2) A clearing member must provide the written disclosure required under subsection (1) to all clearing intermediaries and customers with respect to each derivatives clearing agency through which the clearing member will clear derivatives for the customers.

(3) A clearing member and clearing intermediary must provide written disclosure to all customers outlining the treatment of excess margin in the event of a default by the clearing member or clearing intermediary.

(4) A derivatives clearing agency, clearing member and clearing intermediary must receive confirmation that a customer has acknowledged in writing the receipt of disclosure made under subsections (1), (2) and (3) prior to accepting a cleared derivative from or for that customer.

#### **Disclosure to customers of a clearing intermediary**

**26.** (1) A clearing intermediary must provide prior written disclosure to its customers regarding:

- (a) the risks associated with clearing indirectly through a clearing intermediary; and

- (b) details of arrangements for transferring positions and customer collateral, in the event of the clearing intermediary's default, to a clearing member or to another clearing intermediary.

(2) Prior to accepting a cleared derivative for a customer from a clearing intermediary, a clearing member must receive confirmation that the customer has acknowledged in writing the receipt of the disclosure described in subsection (1).

### **Customer information**

27. (1) A clearing member must:

- (a) at or prior to the first time that the clearing member submits a cleared derivative to the derivatives clearing agency for its customer, provide information to the derivatives clearing agency identifying the customer and the customer's positions and customer collateral; and
- (b) at least once each business day thereafter, provide sufficient information to the derivatives clearing agency for it to identify the positions and customer collateral of each customer.

(2) A derivatives clearing agency must confirm that the information it receives from a clearing member in accordance with subsection (1) from a clearing member is complete and received in a timely manner.

### **Customer collateral report**

28. (1) A clearing member that receives customer collateral must electronically submit to the **[applicable local securities regulator]**, within two business days of the end of each calendar month, a completed Form F1(A) Customer Collateral Report: Clearing Member.

(2) A clearing intermediary that receives customer collateral must electronically submit to the **[applicable local securities regulator]**, within two business days of the end of each calendar month, a completed Form F1(B) Customer Collateral Report: Clearing Intermediary.

(3) A derivatives clearing agency that receives customer collateral must electronically submit to the **[applicable local securities regulator]**, within two business days of the end of each calendar month, a completed Form F1(C) Customer Collateral Report: Derivatives Clearing Agency.

(4) A derivatives clearing agency that receives customer collateral must make available to each of its clearing members a report, calculated on a daily basis, setting out

- (a) the mark-to-market value of each customer's cleared derivative positions;
- (b) the total market value of customer collateral received from the clearing member for the account of each customer of the clearing member; and

- (c) the total market value of customer collateral received from the clearing member that is held by the derivatives clearing agency, and the location or permitted depository where the customer collateral is held.
- (5) A clearing member and clearing intermediary that receives customer collateral must make available to each of its customers a report, calculated on a daily basis, setting out
- (a) the mark-to-market value of the customer's cleared derivative positions;
  - (b) the market value of customer collateral received from that customer;
  - (c) the market value of the customer collateral that is held by the clearing member or clearing intermediary, and the location or permitted depository where the customer collateral is held; and
  - (d) the market value of the customer collateral that is posted
    - (i) by the clearing member with a derivatives clearing agency, or
    - (ii) by the clearing intermediary with a clearing member.

#### **Disclosure of customer collateral investment**

**29.** (1) A derivatives clearing agency, clearing member and clearing intermediary that invests customer collateral must publicly disclose its investment guidelines and policy on its website, in a freely accessible form.

(2) A derivatives clearing agency, clearing member and clearing intermediary must receive confirmation that a customer has acknowledged in writing the receipt of the information under subsection (1) prior to investing customer collateral of that customer.

(3) A derivatives clearing agency, clearing member and clearing intermediary that invests customer collateral must electronically submit a report to the **[applicable local securities regulator]**, in a usable form, as of each calendar quarter end, of the records required to be kept pursuant to section 23.

### **PART 5**

#### **TRANSFER OF POSITIONS**

##### **Transfer of customer collateral and positions**

**30.** (1) Subject to subsection (3) a derivatives clearing agency must facilitate the transfer of customer positions and customer collateral from a defaulting clearing member to one or more non-defaulting clearing members.

(2) At the request of a customer, subject to subsection (3), a derivatives clearing agency must facilitate the transfer of the customer's positions and customer collateral from a non-defaulting



clearing member to one or more non-defaulting clearing members.

- (3) A derivatives clearing agency must facilitate the transfer of positions and customer collateral under subsection (1) or (2), in respect of a customer only if:
- (a) the customer has consented to the transfer;
  - (b) the customer is not currently in default;
  - (c) the transferred position will have appropriate margin at the receiving clearing member;
  - (d) any remaining positions will have appropriate margin at the transferring clearing member; and
  - (e) the receiving clearing member has consented to the transfer(s).

### **Clearing intermediaries**

**31.** A clearing member that permits a person or company to act as a clearing intermediary must establish policies and procedures that include a credible mechanism for transferring the positions and customer collateral of a clearing intermediary's customers, upon a default by the clearing member or clearing intermediary or at the request of a clearing intermediary's customer, to one or more non-defaulting clearing members or one or more non-defaulting clearing intermediaries.

## **PART 6**

### **EXEMPTIONS**

**32.** A Director may grant an exemption to this Rule, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

## **PART 7**

### **EFFECTIVE DATE**

#### **Effective date**

**33.** This Rule comes into force on [•].

**MODEL PROVINCIAL RULE –  
DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER  
COLLATERAL AND POSITIONS**

**FORM F1A – CUSTOMER COLLATERAL REPORT: CLEARING MEMBER**

This Form F1A is to be completed by each clearing member in satisfying its reporting obligations to the [applicable local securities regulator] under subsection 28(1) of Model Provincial Rule – *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (the “Rule”).

Reporting Date	DD/MM/YY
Reporting Period <sup>8</sup>	DD/MM/YY – DD/MM/YY

Reporting clearing member	
LEI and Name	Location

Table A is to be completed by each clearing member that receives customer collateral from a customer or from a clearing intermediary in accordance with the Rule. In Section 1, complete a separate line for each customer that has posted customer collateral to the reporting clearing member. In Section 2, complete a separate line for each customer of a clearing intermediary for whom the clearing intermediary has posted customer collateral to the reporting clearing member. Where an LEI is not available please provide an Interim LEI or, if not available, the complete legal name of the customer.

**Table A**

A.	LEI of customer	Customer collateral			
		Total market value of non-cash customer collateral posted to the clearing member as of the last business day of the Reporting Period	Total market value of customer collateral posted to the clearing member as of the last business day of the Reporting Period	Maximum market value of customer collateral posted to the clearing member during the Reporting Period	Average market value of customer collateral posted to the clearing member over the Reporting Period

<sup>8</sup> The Reporting Period is the calendar month preceding the Reporting Date

Section 1.	[Any customer that has posted customer collateral to the reporting clearing member]				
Section 2.	[Any customer for whom a clearing intermediary has posted customer collateral to the reporting clearing member]				
<u>Aggregate total</u>					

Table B is to be completed by each clearing member that receives customer collateral from a customer or from a clearing intermediary in accordance with the Rule. Complete a separate line for each location at which customer collateral is held by or for the reporting clearing member. Where an LEI is not available please provide an Interim LEI or, if not available, the complete legal and operating name(s) of the permitted depository.

**Table B**

B.	LEI of permitted depository or reporting clearing member	Customer collateral			
		Total market value of non-cash customer collateral held by or for the clearing member as of the last business day of the Reporting Period	Total market value of customer collateral held by or for the clearing member as of the last business day of the Reporting Period	Maximum market value of customer collateral held by or for the clearing member during the Reporting Period	Average market value of customer collateral held by or for the clearing member over the Reporting Period
1.	[Reporting clearing member, if holding customer collateral itself]				
2.	[Any permitted depository holding customer collateral for				

reporting clearing member]				
<u>Aggregate total</u>				

Table C is to be completed by each clearing member that has deposited customer collateral with a derivatives clearing agency in accordance with the Rule. Complete a separate line for each derivatives clearing agency with which the reporting clearing member has deposited customer collateral. Where an LEI is not available, please provide an Interim LEI or, if not available, the complete legal and operating name(s) of the derivatives clearing agency.

**Table C**

C.	LEI of derivatives clearing agency	Customer collateral			
		Total market value of non-cash customer collateral deposited with a derivatives clearing agency as of the last business day of the Reporting Period	Total market value of customer collateral deposited with a derivatives clearing agency as of the last business day of the Reporting Period	Maximum market value of customer collateral deposited with a derivatives clearing agency during the Reporting Period	Average market value of customer collateral deposited with a derivatives clearing agency over the Reporting Period
1.	[Any derivatives clearing agency with which the clearing member has deposited customer collateral]				
	<u>Aggregate total:</u>				

**MODEL PROVINCIAL RULE –  
DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER  
COLLATERAL AND POSITIONS**

**FORM F1B – CUSTOMER COLLATERAL REPORT: CLEARING INTERMEDIARY**

This Form F1B is to be completed by each person or company that acts as clearing intermediary in satisfying its reporting obligations to the [applicable local securities regulator] under subsection 28(2) of Model Provincial Rule – *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (the “Rule”).

Reporting Date	DD/MM/YY
Reporting Period <sup>9</sup>	DD/MM/YY – DD/MM/YY

Reporting clearing intermediary	
LEI and Name	Location

Table A is to be completed by each clearing intermediary that receives customer collateral from a customer in accordance with the Rule. Complete a separate line for each customer that has posted customer collateral to the reporting clearing intermediary. Where an LEI is not available please provide an Interim LEI or, if not available, the complete legal name of the customer.

**Table A**

		Customer collateral			
		Total market value of non-cash customer collateral posted to the clearing intermediary as of the last business day of the Reporting Period	Total market value of customer collateral posted to the clearing intermediary as of the last business day of the Reporting Period	Maximum market value of customer collateral posted to the clearing intermediary during the Reporting Period	Average market value of customer collateral posted to the clearing intermediary over the Reporting Period
A.	LEI of customer				
1.	[Any customer that has				

<sup>9</sup> The Reporting Period is the calendar month preceding the Reporting Date.

	posted customer collateral to the reporting clearing intermediary]				
<u>Aggregate total</u>					

Table B is to be completed by each clearing intermediary that receives customer collateral from a customer in accordance with the Rule. Complete a separate line for each location at which customer collateral is held by or for the reporting clearing intermediary. Where an LEI is not available, please provide an Interim LEI or, if not available, the complete legal and operating name(s) of the permitted depository.

**Table B**

B.	LEI of permitted depository or reporting clearing intermediary	Customer collateral			
		Total market value of non-cash customer collateral held by or for the clearing intermediary as of the last business day of the Reporting Period	Total market value of customer collateral held by or for the clearing intermediary as of the last business day of the Reporting Period	Maximum market value of customer collateral held by or for the clearing intermediary during the Reporting Period	Average market value of customer collateral held by or for the clearing intermediary over the Reporting Period
1.	[Reporting clearing intermediary, if holding customer collateral itself]				
2.	[Any permitted depository holding customer collateral for reporting clearing intermediary]				
<u>Aggregate total:</u>					

Table C is to be completed by each clearing intermediary that has posted customer collateral to a clearing member in accordance with the Rule. Complete a separate line for each clearing member with which the reporting clearing intermediary has deposited customer collateral. Where

an LEI is not available, please provide an Interim LEI or, if not available, the complete legal and operating name(s) of the clearing member.

**Table C**

C.	LEI of clearing member	Customer collateral			
		Total market value of non-cash customer collateral posted to a clearing member as of the last business day of the Reporting Period	Total market value of customer collateral posted to a clearing member as of the last business day of the Reporting Period	Maximum market value of customer collateral posted to a clearing member during the Reporting Period	Average market value of customer collateral posted to a clearing member over the Reporting Period
1.	[Any clearing member with which the clearing intermediary has posted customer collateral]				
<u>Aggregate total:</u>					

**MODEL PROVINCIAL RULE –  
DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER  
COLLATERAL AND POSITIONS**

**FORM F1C – CUSTOMER COLLATERAL REPORT: DERIVATIVES CLEARING  
AGENCY**

This Form F1C is to be completed by each derivatives clearing agency in satisfying its reporting obligations to the [applicable local securities regulator] under subsection 28(3) of Model Provincial Rule – *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (the “Rule”).

Reporting Date	DD/MM/YY
Reporting Period <sup>10</sup>	DD/MM/YY – DD/MM/YY

Reporting clearing derivatives clearing agency	
LEI and Name	Location

Table A is to be completed by each derivatives clearing agency that receives customer collateral from a clearing member in accordance with the Rule. Complete a separate line for each clearing member that has posted customer collateral with the reporting derivatives clearing agency. Where an LEI is not available please provide an Interim LEI or, if not available, the complete legal name of the clearing member.

**Table A**

		Customer collateral			
A.	LEI of clearing member	Total market value of non-cash customer collateral posted to the derivatives clearing agency as of the last business day of the Reporting Period	Total market value of customer collateral posted to the derivatives clearing agency as of the last business day of the Reporting Period	Maximum market value of customer collateral posted to the derivatives clearing agency during the Reporting Period	Average market value of customer collateral posted to the derivatives clearing agency over the Reporting Period

<sup>10</sup> The Reporting Period is the calendar month preceding the Reporting Date.



1.	[Any clearing member that has posted customer collateral with the reporting derivatives clearing agency]				
<u>Aggregate total:</u>					

Table B is to be completed by each derivatives clearing agency that holds customer collateral in accordance with the Rule. Complete a separate line for each location at which customer collateral is held for the reporting derivatives clearing agency. Where an LEI is not available please provide an Interim LEI or, if not available, the complete legal and operating name(s) of the permitted depository.

**Table B**

B.	LEI of permitted depository or reporting derivatives clearing agency	Customer collateral			
		Total market value of non-cash customer collateral held by or for the derivatives clearing agency as of the last business day of the Reporting Period	Total market value of customer collateral held by or for the derivatives clearing agency as of the last business day of the Reporting Period	Maximum market value of customer collateral held by or for the derivatives clearing agency during the Reporting Period	Average market value of customer collateral held by or for the derivatives clearing agency over the Reporting Period
1.	[Reporting derivatives clearing agency, if holding customer collateral itself]				
2.	[Any permitted depository holding customer collateral for reporting derivatives clearing agency]				
<u>Aggregate total</u>					

**MODEL EXPLANATORY GUIDANCE  
TO  
MODEL PROVINCIAL RULE  
DERIVATIVES: CUSTOMER CLEARING AND PROTECTION OF CUSTOMER COLLATERAL  
AND POSITIONS**

**TABLE OF CONTENTS**

<i>PART</i>	<i>TITLE</i>
PART 1	GENERAL COMMENTS
PART 2	TREATMENT OF CUSTOMER COLLATERAL
PART 3	RECORD-KEEPING
PART 4	REPORTING AND DISCLOSURE
PART 5	TRANSFER OF POSITIONS
PART 6	EXEMPTIONS
PART 7	EFFECTIVE DATE

## **PART 1 GENERAL COMMENTS**

### **Introduction**

1. (1) This Model Explanatory Guidance (the “Guidance”) sets out the views of the Canadian Securities Administrators (the “CSA”) OTC Derivatives Committee (the “Committee” or “we”) on various matters relating to Proposed CSA Model Provincial Rule – *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (the “Rule”) and related securities legislation.

(2) Except for Part 1, the numbering of Parts, sections and subsections in this Guidance generally correspond to the numbering in the Rule. Any general guidance for a Part appears immediately after the Part’s name. Any specific guidance on a section or subsection in the Rule follows any general guidance. If there is no guidance for a Part, section or subsection, the numbering in this Guidance will skip to the next provision that does have guidance.

(3) Unless otherwise stated, any reference to a Part, section, subsection, paragraph or definition in this Guidance is a reference to the corresponding Part, section, subsection, paragraph or definition in the Rule.

### **Definitions and interpretation**

2. (1) Unless defined in the Rule, terms used in the Rule and in this Guidance have the meaning given to them in securities legislation,<sup>11</sup> including, for greater certainty, National Instrument 14-101 *Definitions* and OSC Rule 14-501 *Definitions*.<sup>12</sup>

### **Interpretation of terms used in the Rule and in the Guidance**

3. A number of key terms are used in the Rule,

(1) “clearing” refers to the process of establishing positions, through novation or otherwise, arising from cleared derivatives, substituting the credit of the parties with the credit of the derivatives clearing agency, and includes arranging or providing, on a multilateral basis, for the calculation, settlement or netting of obligations resulting from such positions, and ensuring that financial instruments, cash, or both, are available to secure the exposures arising from such positions.

(2) The term “lien” refers to a creditor’s claim against property to secure repayment of a debt.

(3) The term “position” refers to the transacted financial asset that has been cleared by a derivatives clearing agency.

(4) The term “segregate” refers to a method of protecting customer collateral by accounting for or holding customer collateral separately from the property of other persons or companies.

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<sup>11</sup> As explained in the accompanying Notice, the Customer Clearing Rule has been drafted based on the *Securities Act* (Ontario). Certain conforming amendments will be necessary in other jurisdictions.

<sup>12</sup> The reference to OSC Rule 14-501 *Definitions* is only relevant in Ontario. Other jurisdictions may have a similar local rule.

(5) The term “commingle” refers to combining customer collateral of a customer with the customer collateral of another customer in a single account or transfer. A customer’s collateral may be segregated at one level, for example, from a clearing member’s proprietary property while being commingled at another level with the property of other customers.

### **Interpretation of terms defined in the Rule**

4. (1) A “cleared derivative” is a derivative that is cleared by a customer, either voluntarily or in accordance with the clearing requirement set out in Proposed CSA Model Provincial Rule – *Mandatory Central Counterparty Clearing of Derivatives* (the “Clearing Rule”) and as recommended in *CSA Consultation Paper 91-406 – Derivatives OTC Central Counterparty Clearing* (the “Clearing Paper”).

(2) A “clearing intermediary” is a person or company that is not a clearing member of the derivatives clearing agency but does facilitate clearing on behalf of a customer. In order to clear its customer’s transaction, the clearing intermediary would enter into an agreement with a clearing member who would submit the transaction to the derivatives clearing agency to be cleared. This clearing relationship is often referred to as “indirect customer clearing”. It is possible that a person or company that is a clearing member at one derivatives clearing agency could also act as a clearing intermediary in order to access another derivatives clearing agency, of which it is not a member. A person or company providing clearing intermediary services in respect of a cleared derivative would be considered a party to that transaction for the purposes of this Rule. A clearing intermediary may also be a customer if it clears its proprietary transactions through a clearing member.

The Committee expects that, subject to any available exemption, a clearing intermediary offering clearing services to a customer will be required to register as a derivatives dealer. CSA Consultation Paper 91-407 – *Derivatives: Registration* outlines the recommended business trigger for determining whether a person is in the business of trading derivatives.<sup>13</sup> These factors include intermediating trades and providing clearing services to third parties. Please refer to the consultation paper for further details.

(3) There are two situations in which a party to a cleared derivatives transaction is considered to be a “customer” for the purposes of this Rule. The first situation is where the customer is located in [the applicable province].

The second situation is where the derivatives clearing agency or party providing clearing services to a foreign party is located in the [applicable province]. For example, if a derivatives dealer located in Ontario is providing clearing services to a foreign party it would be required to treat the foreign party as a customer.

A clearing member is not considered to be a customer where it transacts with its derivatives clearing agency.

The Committee expects that, subject to any available exemption, a clearing member offering clearing services to a customer will be required to register as a derivatives dealer. CSA Consultation Paper 91-407 – *Derivatives: Registration* outlines the recommended business trigger for determining whether a

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<sup>13</sup> See Subsection 6.1(b) of CSA Consultation Paper 91-407 – *Derivatives: Registration* available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

person is in the business of trading derivatives.<sup>14</sup> These factors include intermediating trades and providing clearing services to third parties. Please refer to the consultation paper for further details.

(4) The definition of “customer account” applies to customer accounts at each level of the clearing chain. For example, to the extent that a customer transaction is initiated with a clearing intermediary, it is possible that a portion of customer collateral for that transaction could be held directly or at a permitted depository by each of the clearing intermediary, clearing member and derivatives clearing agency. In such a case there would be three customer accounts associated with the transaction: one at each of the clearing intermediary, clearing member and derivatives clearing agency.

(5) The term “customer collateral” refers to property received or held by a clearing member, clearing intermediary or derivatives clearing agency from or on behalf of a customer. The Committee wishes to point out that although a customer may deliver certain collateral to a clearing member or clearing intermediary this specific collateral may not be the collateral delivered to the derivatives clearing agency to satisfy margin requirements. A clearing member or clearing intermediary may “upgrade” or “transform” the collateral delivered by the customer pursuant to an agreement between the parties. For example, a customer may deliver cash as collateral and pursuant to an agreement the clearing member may deliver securities of an equivalent value to the derivatives clearing agency. Any collateral delivered to the derivatives clearing agency on behalf of a customer would be considered customer collateral.

(6) The term “excess margin” refers to any customer collateral that is collected by a clearing member or clearing intermediary from a customer in excess of the amount of margin required by the derivatives clearing agency for the positions of such customer. Excess margin may be held by the clearing member or clearing intermediary (or permitted depository) in accordance with subsection 4(1), or transferred to a derivatives clearing agency if the preconditions set out in section 5 are met.

(7) The term “initial margin” refers to collateral required by a derivatives 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.

Initial margin for a customer of a clearing member can be collected or credited to a customer account or on behalf of a customer either at the derivatives clearing agency, clearing member or clearing intermediary. This implies that all collateral, whether provided by the customer or not, sent or intended to be sent to the derivatives clearing agency to satisfy an initial margin requirement of the derivatives clearing agency for that customer is considered to be initial margin under this rule.

(8) A “permitted depository” is an acceptable organization for holding customer collateral deposited with a clearing member, clearing intermediary or derivatives clearing agency. In recognition of the international nature of the derivatives market, subsection (f) of the definition permits foreign banks, loan companies or trust companies to act as permitted depositories, and thus hold customer collateral, provided they are regulated in a similar manner as would be applicable to such entities if they were located in Canada. The Committee would interpret a “similar manner” to mean regulations and oversight that ensures such entities provide the necessary protection for customer collateral from a prudential and operational standpoint. A clearing agency located in a foreign jurisdiction would only be acceptable as a permitted depository if it is recognized or exempted in [the applicable province].

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<sup>14</sup> See Subsection 6.1(b) of CSA Consultation Paper 91-407 – Derivatives: Registration available at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

The Committee is also of the view that a clearing member, clearing intermediary or derivatives clearing agency that holds customer collateral at a permitted depository in accordance with this Rule should take reasonable commercial efforts to confirm that the permitted depository:

- has appropriate rules, procedures, and controls, including robust accounting practices, to help ensure the integrity of the customer collateral and minimise 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; and
- if applicable, the foreign entity qualifies as a permitted depository under paragraph (f).

(9) The term "permitted investment" sets out a principles-based approach to determining the types of instruments in which a clearing member, clearing intermediary or derivatives clearing agency may invest customer collateral, in accordance with the provisions of this Rule. 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.

The Committee is of the view that a clearing member, clearing intermediary or derivatives clearing agency that invests customer collateral in accordance with this Rule should 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
- can be liquidated quickly with little, if any, adverse price effect.

The Committee is also of the view that a clearing member, clearing intermediary or derivatives clearing agency should not invest customer collateral in its own securities or those of its affiliates. Examples of instruments that would be considered permitted investments by the [applicable local securities regulator] include:

- 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);
- commercial paper fully guaranteed as to principal and interest by the Government of Canada; and
- interests in money market mutual funds.

The Committee is of the view that foreign investments exhibiting the same conservative characteristics as the instruments listed above would also be acceptable.

(10) The term “variation margin” refers to collateral required by a derivatives clearing agency to cover losses resulting from changes in the current value of a cleared derivative with the derivatives clearing agency.

Variation margin for a customer of a clearing member can be collected or credited to a customer account or on behalf of a customer either at the derivatives clearing agency, clearing member or clearing intermediary. This implies that all collateral, whether provided by the customer or not, sent or intended to be sent to the derivatives clearing agency to satisfy a variation margin requirement of the derivatives clearing agency for that customer is considered to be variation margin under this rule.

## **PART 2**

### **TREATMENT OF CUSTOMER COLLATERAL**

Part 2 contains rules for the treatment of customer collateral by derivatives clearing agencies, clearing members, and clearing intermediaries.

#### ***Collection of initial margin***

**2.** (1) The requirement that a derivatives clearing agency collect initial margin on a gross basis for each customer means that a derivatives clearing agency may not, and may not permit its clearing members to, offset initial margin positions of different customers against one another. However, the initial margin collected from an individual customer may be determined by netting across the various over-the-counter (OTC) derivative positions of that customer. Further, there is no prohibition on a derivatives clearing agency collecting variation margin for customer cleared derivatives on a net basis from its clearing members.

Margin requirements would be determined by the derivatives clearing agency in accordance with its rules, policies, and procedures. Please see proposed OSC Rule 24-503 *Clearing Agency Requirements* for requirements applicable to clearing agency margin calculation.

(2) Because a derivatives clearing agency is required under subsection 2(1) to collect initial margin on a gross basis, a clearing member must also collect initial margin on a gross basis in order to comply with subsection 2(2).

### ***Segregation of customer collateral***

3. Subsection 3(1) requires a derivatives clearing agency, clearing member and clearing intermediary to segregate customer collateral from its own property, including from collateral advanced for a proprietary position. For example, a clearing member's proprietary positions (house account) would be required to be held separately from customer positions. Similarly, a clearing intermediary would be required to set up a separate account for its customers with its clearing member, so that the clearing intermediary's proprietary positions are held separately from those of its customers. Records maintained by each of the derivatives clearing agency, clearing member and clearing intermediary must make it clear that customer accounts are held for the benefit of customers. The Committee recognizes that methods for holding customer collateral at the clearing member or clearing intermediary level may differ depending on collateral and entity type.

The Committee is of the view that parties should enjoy flexibility in their collateral arrangements. For example, notwithstanding the legal arrangement under which customer collateral is deposited with a clearing member, the clearing member must treat customer collateral posted with it as belonging to customers. This principle remains in effect in a title transfer collateral arrangement, where the title to the property posted as collateral is transferred to the entity collecting the collateral. Despite any such transfer of legal title from the customer to the clearing member, a clearing member must treat any property transferred as collateral by or on behalf of a customer and relating to that customer's cleared derivatives, as customer collateral.

(2) Subsection 3(2) permits the customer collateral of multiple customers to be commingled in an omnibus customer account. However, the clearing member or clearing intermediary is responsible through its record keeping requirements in Part 3 to identify the positions and collateral held for each individual customer within the omnibus customer account. Further, subsection 8(1) prevents the use of customer collateral attributable to one customer to satisfy the obligations of another customer. As a result, although the customer collateral may be held in one omnibus account, such collateral is not available to satisfy customer obligations generally. Only customer collateral attributable to a customer may be used to satisfy the obligations of that customer. Customer collateral may not be commingled with the property of any person or company that is not a customer. For example the collateral of a futures customer may not be commingled with the collateral of a cleared derivatives customer.

(3) Subsection 3(3) also requires a derivatives clearing agency to segregate customer collateral relating to cleared derivatives from any other type of customer property, including any other property posted by a customer as collateral relating to another position, investment or financial instrument. For example, the customer collateral of a customer may not be commingled with collateral relating to a futures transaction, or any other property or collateral, of the same customer, or of any other customer.

### ***Holding of customer collateral***

4. (2) Subsection 4(2) requires a derivatives clearing agency, clearing member and clearing intermediary that holds customer collateral directly to provide reasonable protection to such collateral. Where collateral is in a physical form the Committee would interpret this requirement to mean a secure physical location with sufficient record keeping to identify the collateral as belonging to a customer. Where collateral is in an electronic form this would mean a secure electronic location with suitable back-up



facilities and disaster recovery plans as well as sufficient record keeping to identify the collateral as belonging to a customer.

***Excess margin***

5. The Committee would interpret the requirement that a derivatives clearing agency, clearing member and clearing intermediary identify all excess margin held to only apply to the excess margin held by such entity. For example a derivatives clearing agency would not be required to keep records relating to excess margin held by a clearing intermediary.

***Clearing member maintenance of customer account balance***

6. Section 6 requires a clearing member to ensure sufficient collateral in customer accounts. To prevent a margin deficit a clearing member may deposit its own funds into the account pursuant to section 7.

***Clearing member and clearing intermediary deposits in customer accounts***

7. (1) Subsection 7(1) permits a clearing member or clearing intermediary to deposit its own property into a customer account in order to meet an intra-day margin call from a derivatives clearing agency. Such a deposit may be made, for example, in order to avoid making a follow-on intra-day margin call to the customer where the customer has agreed to meet margin on a once-daily basis.

(3) Subsection 7(3) requires that prior to any withdrawal of property deposited in accordance with subsection 7(1), the clearing member or clearing intermediary must reflect in its books and records the value of customer collateral required from each customer and the total sum of those amounts including any excess or deficit in customer collateral. Under section 6 the clearing member or clearing intermediary is prohibited from withdrawing property from the customer account if the customer account has less collateral than required by the derivatives clearing agency or would have less as a result of the withdrawal.

***Use of customer collateral***

8. (4) Subsection 8(4) is a general rule prohibiting a lien on customer collateral. The exception to the general rule is where the lien arises in connection with the cleared derivative. This exception recognizes that certain clearing arrangements involve the granting of security interests in customer collateral. Should an improper lien be imposed on customer collateral the relevant party must take all commercially reasonable steps to promptly address the improper lien.

### ***Investment of customer collateral***

**9.** Section 9 provides that a derivatives clearing agency, clearing member or clearing intermediary may invest customer collateral that is deposited with it, but only in a permitted investment as that term is defined in the Rule. The Committee is of the view that parties should be free to contract for the allocation of gains resulting from a derivatives clearing agencies, clearing member's or clearing intermediary's investment activities in accordance with this Rule. However, any loss resulting from a permitted investment of customer collateral must be borne by the investing clearing member or clearing intermediary. No loss in the value of invested customer collateral shall be allocated to a customer(s) or customer account(s).

### ***Risk management***

**11.** Risk exposures that a derivatives clearing agency must identify attributable to interactions with clearing members, clearing intermediaries and their customers (the "Entities") include but are not limited to: market risk resulting from the cleared positions of the Entities including concentrations in positions and potential wrong-way risk exposures; credit risk of the Entities as it relates to the likelihood of default or a failure to make required margin payments on a timely basis; operational risks of connecting to the Entities insofar as these connections impair the ability of the derivatives clearing agency to operate efficiently; reputational risk of having business relationships with the Entities insofar as it damages the confidence that other clearing members, clearing intermediaries, customers and the [applicable local securities regulator] have in the derivatives clearing agency's ability to operate effectively.

These risks should be monitored by the derivatives clearing agency on a periodic basis, managed according to a defined process or policy and disclosed periodically as required by the [applicable local securities regulator].

### ***Same***

**13.** This provision prevents any person or company from providing customer clearing services unless it is prudentially regulated by an appropriate regulatory authority. Such prudential regulation should ensure that a clearing member or 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 Office of the Superintendent of Financial Institutions (OSFI). Other regulators that perform prudential oversight include the Investment Industry Regulatory Organization of Canada (IIROC) and certain provincial prudential market regulators, such as the Autorité des marchés financiers in Québec or other local securities regulators when the proposed registration regime for OTC derivatives is implemented. An appropriate foreign regulatory authority would be one that applies a regulatory standard similar to that which applies to Canadian entities.

### ***Clearing member default***

**14.** Although this provision prevents a derivatives clearing agency from applying customer collateral to satisfy the obligations of a defaulting clearing member, it does not preclude the derivatives clearing agency from applying a defaulting customer's collateral to satisfy the obligations of that customer.

### **PART 3 RECORD-KEEPING**

Part 3 outlines the minimum record-keeping requirements that apply to derivatives clearing agencies, clearing members, and clearing intermediaries. The effectiveness of the customer protections required under this Rule is predicated on accurate and thorough record-keeping by derivatives clearing agencies, clearing members and clearing intermediaries.

#### ***Retention of records***

**16.** The records required to be prepared pursuant to this section must be retained for seven years, in accordance with record retention practice in Canada and the timing requirements under the [*Limitations Act 2002 (Ontario)*].<sup>15</sup>

#### ***Books and records***

**17.** (4) The Committee is of the view that accurate record-keeping requires, at minimum, daily valuations of customer collateral. With respect to records required to be kept under subsection (4) and to the assets of property included in the customer collateral of a customer,

(a) item (a) 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;

(b) item (b) 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

(c) item (c) refers to charges that have accrued, or may accrue, against the customer and have been agreed to between the derivatives clearing agency, clearing member or clearing intermediary and 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.

#### ***Separate records – clearing members and clearing intermediaries***

**21.** Where a clearing member permits a person or company to act as a clearing intermediary, the clearing member assumes a record-keeping obligation relating to the customers of the clearing intermediary. The clearing member's books and records should separately identify the customer collateral and positions of each of the customers of its clearing intermediaries.

#### ***Records of investment of customer collateral***

**23.** Paragraph 23(1)(d) refers to a description of the instrument(s) in which an investment has been made; the Committee is of the view that this item requirement would be fulfilled by providing a unique identifier from an industry-accepted identifying standard, such as an ISIN or CUSIP number.

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<sup>15</sup> The *Limitations Act 2002 (Ontario)* is only relevant in Ontario. Other jurisdictions may have similar provincial legislation.

### ***Records of currency conversion***

**24.** Section 24 requires a derivatives clearing agency, clearing member or clearing intermediary to make and keep records of each conversion of customer funds from one currency into another. The Committee is of the view that a currency exchange transaction records should include, at minimum, the following information:

- the identity of the customer as represented by their Legal Entity Identifier;
- the type or source of funds;
- 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; and
- the name of the institution which made the exchange and/or provided the exchange rate.

## **PART 4 REPORTING AND DISCLOSURE**

Part 4 outlines certain disclosure and reporting required to be made by a clearing member, clearing intermediary or derivatives clearing agency to customers, and the [applicable local securities regulator]. The Committee acknowledges the confidential nature of the information that must be reported to the [applicable local securities regulator].

### ***Disclosure to clearing members and customers***

**25.** The disclosure provided under Section 25 should assist customers in evaluating the level of protection provided, 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 any risks or uncertainties associated with such arrangements. Disclosure helps customers to assess the related risks and conduct due diligence when entering into transactions that are cleared through a clearing member at the derivatives clearing agency. The disclosure can be provided in electronic form by delivering copies of required materials or providing links to online information.

Examples of the information that the disclosure should provide include:

- How the application of bankruptcy and insolvency laws may impact the derivatives clearing agency's ability, in relation to its clearing members, clearing intermediaries and customers, to expeditiously terminate such relationships; transfer customer collateral; and enforce rights in relation to customer collateral.
- The interaction of laws applicable to customer collateral.

(3) Subsection 25(3) requires a clearing member or clearing intermediary to provide disclosure with respect to customer collateral that is held by them. Customer collateral held at the clearing member or clearing intermediary level may receive different treatment from customer collateral held at the derivatives clearing agency in the event of a clearing member or clearing intermediary bankruptcy or insolvency. In particular, there may be situations where customer collateral held in a customer account would be combined with the property of other non-cleared derivatives customers. The disclosure required by this provision should provide customers with clear information on the treatment of their collateral in a default situation.

### *Disclosure to customers of a clearing intermediary*

**26.** The clearing intermediary should disclose to a customer any information relating to additional risks to customer positions and customer collateral that arise as a result of the indirect clearing relationship.

### *Customer information*

27. (1) In order to facilitate a timely transfer of collateral and positions in a default scenario, a derivatives clearing agency should have sufficient information to identify each customer of a clearing member or clearing intermediary, and the customer's positions and customer collateral. This identifying information shall be submitted by the responsible clearing member to each relevant derivatives clearing agency, and shall include the Legal Entity Identifier (assigned in accordance with standards set by the Global Legal Entity Identifier System) or name of the customer. On a regular basis thereafter, and at least once each business day, the responsible clearing member shall provide updated reports to the derivatives clearing agency, with sufficient information to accurately identify the collateral and positions of each customer.

### *Customer collateral report*

28. The Committee is of the view that regular reporting on customer collateral deposits and holdings will assist the provincial securities regulatory authorities in monitoring customer collateral arrangements and developing and implementing rules to protect customer assets that are responsive to market practices. To that end, subsections 28(1), (2) and (3) set out reporting requirements for clearing members, clearing intermediaries, and derivatives clearing agencies respectively, regarding customer collateral. A completed Form F1A, Form 1B or Form F1C will provide the [applicable local securities regulator] with a snapshot of the value of collateral held by or deposited by the reporting clearing member, clearing intermediary or derivatives clearing agency.

### *Disclosure of customer collateral investment*

29. (2) The Committee is of the view that the requirement to receive a written acknowledgement may be satisfied by directing a customer to the disclosure on the derivatives clearing agency's website and have online procedures in place for the customer to acknowledge that it has received such information.

## **PART 5 TRANSFER OF POSITIONS**

Part 5 provides for the transfer of customer collateral and positions from one clearing member or clearing intermediary to another clearing member or clearing intermediary, either in a default scenario or

by request of the customer. Part 5 also addresses, in part, the following recommendation included in *CSA Consultation Paper 91-404 – Derivatives: Segregation and Portability in OTC Derivatives Clearing*:

“Each CCP shall have rules facilitating the termination of contractual relationships between a clearing member and its customers and the transfer of positions.”

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 when a clearing member or clearing intermediary defaults or is undergoing insolvency proceedings.

#### *Transfer of customer collateral and positions*

30. (1) The Committee is of the view that operations, policies and procedure of all parties offering clearing services should be structured to ensure, to the greatest extent possible, that a default by a clearing member does not affect the positions and collateral of the defaulting clearing member’s customers. A clearing member default would generally occur when a clearing member does not, or is unable to, meet its obligations at a derivatives clearing agency.

To ensure that customer collateral and positions are insulated from a clearing member default, including any winding-up or restructuring proceeding of the defaulting clearing member, a derivatives clearing agency must have rules and procedures in place to effectively and promptly facilitate the transfer customer collateral and positions to another, non-defaulting clearing member. A “non-defaulting clearing member” is a clearing member that (i) has not defaulted, and is not reasonably expected to default on its obligations at a derivatives clearing agency as they come due, and (ii) is not in default, as that term is defined in the rules and procedures of the relevant derivatives clearing agency.

The Committee is of the view that customer collateral and positions should be transferred as seamlessly as possible from the perspective of the customer. This means that a customer’s positions should be maintained on the identical economic terms as govern the position immediately before the transfer. The Committee is of the view that, in effecting such a transfer, a derivatives clearing agency shall be permitted to operationally close-out and re-book the positions, provided that the ultimate result is that the customer’s positions are maintained on the identical economic terms as governed immediately before the transfer.

The derivatives 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 customers’ portfolio. The derivatives clearing agency should therefore 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 clearing members, taking into account all relevant circumstances. In order to achieve a high likelihood of transferability, the derivatives clearing agency will need to have the ability to identify positions that belong to customers, identify and assert the derivatives clearing agency’s rights to related customer collateral held by or through the derivatives clearing agency, transfer positions and related customer collateral to one or more other clearing members, identify potential clearing members to accept the positions, disclose relevant information to such clearing members so that they can evaluate the

counterparty credit and market risk associated with the customers and positions, respectively, and facilitate the derivatives clearing agency's ability to carry out its default management procedures in an orderly manner. The derivatives clearing agency's policies and procedures should provide for the proper handling of customer collateral and related positions of customers of a defaulting clearing member.

Although the Committee stresses the importance of the transfer of customer collateral and positions in a default scenario it acknowledges that there may be circumstances where the portability of all or a portion of a customer's position is not possible. Where a derivatives 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 clearing member's customers.

The Committee is of the view that a clearing member should also have policies and procedures in place to promptly transfer customer collateral that it holds to one or more non-defaulting clearing members in the event of its own default.

(2) A derivatives clearing agency must have rules and procedures in place to facilitate the transfer of the customer collateral and positions of a customer from one clearing member to another, non-defaulting clearing member at the request of the customer. This is also known as a "business-as-usual transfer".

A customer should be able to transfer its customer collateral and positions to another clearing member in the normal course of business. Subsection 30(2) requires a derivatives clearing agency to have rules and procedures that require clearing members to facilitate the transfer of customer collateral and related positions upon the customer's request, subject to any notice or other contractual requirements.

(3) Where a transfer of customer collateral and positions is facilitated under subsection (1) or (2), a derivatives clearing agency must promptly transfer the customer's positions and related customer collateral, as a single portfolio or in portions as requested by the customer, to one or more non-defaulting clearing members.

Subsection (3) sets out certain pre-conditions for the transfer of customer collateral and positions, in either a default or business-as-usual transfer. The derivatives clearing agency must obtain the consent of the customer with respect to the transfer of the customer collateral and positions of the customer to the particular transferee clearing member. The Committee is of the view that this consent may be best obtained at the outset of a clearing relationship, and by allowing a customer to identify clearing members to which they would consent, *a priori*, to such a transfer. If there are circumstances where this consent would not be obtained, or where the prior consent would not be followed, those circumstances should be set out in the rules, policies, or procedures of the derivatives clearing agency.

The derivatives clearing agency must also obtain the consent of the receiving clearing member as to which positions and customer collateral are to be transferred. If there are circumstances where this would not be the case, those circumstances should be set out in the rules, policies, or procedures of the derivatives clearing agency.

***Clearing intermediaries***

**31.** The Committee is of the view that customers of a clearing intermediary should benefit from the same protections and rights, with respect to the transfer of positions and collateral as are provided for customers of a clearing member. To that end, a clearing member that permits a customer to act as a clearing intermediary must have in place a credible mechanism to transfer the customer collateral and positions of a customer of that clearing intermediary, either in a default by the clearing intermediary or clearing member or on request of the customer. A clearing member must promptly facilitate such a transfer, as a single portfolio or in portions as requested by the customer, to one or more non-defaulting clearing members or one or more non-defaulting clearing intermediaries.