ANNEX A

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

1. Issue/Reference	2. Summary of Comments	3. Response
GENERAL COMMENTS		
Harmonization of rules	A number of commenters emphasized the importance of harmonizing the Canadian derivatives regime with international rules and standards.	The Committee agrees and is committed to implementing harmonized rules consistent with international standards. See also the substituted compliance section below.
	One commenter suggested that provincial rules should be consistent and implementation timelines should be coordinated to avoid regulatory arbitrage.	Change made. The Committee notes that it has now opted to develop a national instrument, given its intention that the substance of the Model Rule be the same across local jurisdictions and that market participants and derivative products receive the same treatment across Canada.
Amendments to personal property security and bankruptcy regimes	A number of commenters emphasized the importance of ensuring that personal property security and insolvency laws work with the Proposed National Instrument in order for Canadian participants to remain competitive on a global level.	The Committee is seeking to implement requirements which protect customer collateral, to the extent possible, under existing Canadian federal and provincial legal frameworks. The Committee notes that federal bankruptcy and provincial personal property security legislation are regimes which fall outside of the jurisdiction of the provincial securities regulatory authorities.
Customer protection model	Two commenters explained that the Model Rule is not compatible with the principal to principal model for customer clearing used in the European Union. One commenter asked which customer protection regime is proposed to be implemented in Canada.	Multiple changes made. The Instrument now facilitates the offering of various models of customer clearing including the principal to principal model.

Type of collateral accepted by a Derivatives Clearing Agency	A number of commenters suggested that the Committee should ensure that clearing agencies accept various types of Canadian collateral and/or increase the maximum amounts of such collateral they accept.	No change. The Committee recognizes the importance of Canadian clearing intermediaries and customers having the ability to utilize a broad range of collateral when posting collateral with a regulated clearing agency. Subject to the requirements and guidance provided in National Instrument 24-102 *Clearing Agency Requirements* and its companion policy, it is the Committee's view that it should generally not prescribe the types of collateral a regulated clearing agency should accept, nor the limits it should place on that collateral. A request that a regulated clearing agency accept specific forms of collateral should be made by a clearing intermediary to the clearing agency, which would then go through its normal risk management process.
Substituted compliance	One commenter suggested that foreign-based recognized clearing agencies be permitted to comply by way of substituted compliance so as to avoid duplicative and onerous regulation.	The Committee will consider substituted compliance where a regulated clearing agency is subject to equivalent regulation. See Part V, subparagraph (b)(ii) of the Notice for a description of the Committee's substituted compliance proposal.
PART 1: DEFINITIONS		
s. 1 – "clearing intermediary"	Two commenters suggested that the definition of "clearing intermediary" be expanded to include a scenario where there are multiple clearing intermediaries in a chain. One commenter suggested that financial intermediaries should be permitted to post collateral and meet reporting requirements on behalf of credit unions	Change made. The Instrument permits more than one clearing intermediary to be involved in a customer transaction. The Instrument does not prohibit clearing intermediaries from posting collateral on behalf of and fulfilling reporting requirements for their customers.
s. 1 – "customer collateral"	One commenter explained that the obligation to segregate variation margin is not possible for clearing agencies under certain customer protection models once the amount has been paid out to the clearing intermediary.	No change. Variation margin provided by a customer to its clearing intermediary is customer collateral and required to be segregated.

s. 1 – "excess margin"	One commenter suggested that the definition of "excess margin" be revised (i) to reflect that collateral is not excess margin until it is delivered to a clearing intermediary or clearing agency, and (ii) to clarify that any collateral delivered by a customer to a clearing agency or clearing intermediary which will be transformed should not be considered excess margin (i.e., it is the transformed collateral that is to be considered excess margin).	Change made. The definition has been revised to indicate that excess margin is customer collateral that has been delivered to a regulated clearing agency or clearing intermediary. Additionally, the CP has been revised to provide guidance clarifying that customer collateral initially delivered may be transformed and once transformed, only the transformed collateral is considered customer collateral and therefore excess margin.
	One commenter suggested that the definition be clarified to ensure that only collateral provided as margin for the customer's derivatives is included in the definition. Specifically, the commenter was concerned that confusion would arise where a customer provided a security interest in various collateral in accordance with standard customer account documentation (e.g., a security interest in all securities accounts or a security interest in all present and after-acquired property) that was not being used as margin for its derivative transactions. Another commenter suggested that the definition should be expanded to include collateral that is delivered by a customer in excess of the amount required by a clearing agency for operational efficiencies.	Change made. The definition has been revised to specify that excess margin is collateral in respect of a customer's cleared derivatives that is in excess of the amount of margin required by the regulated clearing agency to clear and settle such derivatives.
s. 1 – "permitted depository"	Two commenters suggested expanding the definition of "permitted depository" to include all entities through which collateral is currently being held by clearing agencies with global operations. Specifically, one commenter suggested expanding the definition to include securities settlement systems. The other commenter suggested that the definition should be broad enough to cover all potential securities intermediaries within an indirect holding system.	Change made. The definition in the Instrument covers various types of entities that are subject to a minimum amount of oversight required to ensure safekeeping of customer collateral including clearing intermediaries in the customer clearing chain that receive customer collateral. Other entities not covered by the definition may be granted an exemption on a case-by-case basis.
s. 1 – "permitted investment"	Two commenters suggested that minimum ratings (e.g., S&P, DBRS, Moody's) should be added as a requirement for an investment to be permitted and that the corresponding ratings be noted with the records of investment of customer collateral required under s. 23 of the Model Rule.	No change. The Committee has taken a principles based approach to permitted investments that does not rely on prescriptive requirements such as ratings.

PART 2: TREATMENT OF CUSTOMER COLLATERAL		
s. 2 – Collection of initial margin		
General Comments	Two commenters suggested that Canadian market participants should be given the choice to have initial margin requirements calculated in Canadian dollars.	No change. It is the Committee's view that it is not appropriate to include a requirement that could introduce foreign exchange risk. If collateral is only calculated, but not accepted in Canadian dollars, this would not be a useful service because the calculation would not represent the currency required to be delivered.
s. 2(1)	One commenter suggested amending the Model Rule so that initial margin can be collected by either gross or net methods. Another commenter also requested the Model Rule be amended to permit netting of collateral requirements.	No change. There is a greater likelihood that customer positions may be under-margined when collected on a net-basis. However, the Committee has amended the Model Rule to allow excess margin to be used to secure or extend credit to a customer.
s. 2(2)	One commenter suggested that it is not necessary to include a requirement for a clearing intermediary to collect initial margin given that s. 6 of the Model Rule obligates a clearing intermediary to keep sufficient property with a clearing agency.	Change made. The section has been removed from the Instrument.
	One commenter suggested that it be clarified whether a clearing intermediary may use its own property to fund initial margin requirements set by a clearing agency.	No change. There is no prohibition in the Instrument against a clearing intermediary using its own property; however, any property provided must be treated as customer collateral.
s. 3 – Segregation of customer collateral		
s. 3(2)	Two commenters suggested that the Model Rule should allow the option for customers to request that customer collateral be held using the Full Physical Segregation Model.	No change. The Committee is of the view that the Full Physical Segregation Model may be more costly than its alternatives and may not materially improve the degree of protection for customers of a clearing intermediary and therefore, there is no requirement that a clearing agency offer the Full Physical Segregation model. However, a customer may privately contract with a clearing intermediary or regulated clearing agency for Full Physical Segregation.

s. 3(3)	Two commenters requested that the Model Rule not prohibit portfolio margining, and also requested that a mechanism for allowing portfolio margining be included.	No change. The Committee will continue to monitor developments in the market, and may make changes to the Proposed National Instrument, as necessary.
s. 4 – Holding of customer collateral		
General Comments	One commenter pointed out that Part 2 of the Model Rule permits commingling of customer collateral from multiple customers by clearing agencies and clearing intermediaries and that this seemed to contradict the requirement for individually segregated accounts to be held at a permitted depository. Additionally, two commenters suggested that the Model Rule should permit commingling of customer collateral.	Change made. Additional guidance has been added to the CP clarifying that customer collateral of multiple customers may be commingled in an omnibus customer account. The Instrument requires that the clearing intermediaries and clearing agencies identify the positions and collateral held for each individual customer within an omnibus customer account. Where a clearing intermediary or clearing agency deposits customer collateral with a permitted depository, the clearing intermediary or clearing agency is responsible for ensuring the permitted depository maintains appropriate books and records to ensure customer collateral can be attributed to each customer.
s. 4(3)	One commenter expressed concern regarding the requirement that all customer collateral be held in a segregated account that clearly identifies the name of each customer or otherwise indicates that the property in the account is customer collateral. The commenter's concern was that this may jeopardize the absolute transfer characterization of cash in such circumstances.	Change made. The Instrument does not require that the name of each customer whose customer collateral is held at a permitted depository be identified on the account, provided that the account is identified as holding customer collateral.
s. 6 – Clearing member maintenance of customer account balance		
s. 6	Three commenters suggested clarifying that clearing agency margin calls are to take place once each day, and that clearing intermediaries will not be required to cure any customer collateral shortfall on a continuous basis.	No change. The clearing intermediary will be required to meet the margin requirements of the clearing agency within the time limits set out by the clearing agency.

s. 8 – Use of customer collateral		
s. 8	One commenter expressed the view that market participants should have the right to contract in respect of excess collateral as they deem appropriate without restriction, and thus that the Model Rule should expressly allow the re-hypothecation of excess margin to the extent it is held by a clearing agency or clearing intermediary.	Change made. The Instrument has been revised to articulate that customer collateral may be bought or sold pursuant to an agreement for resale or repurchase under prescribed conditions.
	One commenter suggested that the Model Rule should expressly allow a clearing intermediary or a clearing agency to offer collateral transformation services to the customer.	Change made. The CP explains that collateral transformation is acceptable and transformed collateral would be considered customer collateral.
	One commenter noted that the CFTC's rules expressly provide for the right to withdraw customer collateral from a customer account to margin, guarantee, secure, transfer, adjust or settle the customer's cleared transactions and requested that the Model Rule make this point distinctly.	Change made. The language in the Instrument expressly grants this right.
	One commenter noted that margin held at the clearing intermediary level should be permitted to secure other obligations of the customer to the clearing intermediary.	Change made. Excess margin held by a clearing intermediary may be used to secure or extend credit to the customer.
s. 9 – Investment of customer collateral		
s. 9(1)	One commenter suggested that customers should be permitted to restrict how customer collateral is invested.	No change. The Instrument restricts investment of customer collateral to conservative investments (determined using a principles-based approach) and it is the Committee's view that further restrictions should be a private contractual matter between customers and clearing intermediaries or clearing agencies.
	One commenter suggested that a requirement to report all losses and gains made on investments of customer collateral be added to the Model Rule.	No change. Section 26 of the Instrument requires that the customer receive a daily report setting out the current value of customer collateral. This report includes any daily changes in the value of invested customer collateral.

s. 9(2)	One commenter expressed concern that a clearing intermediary may be liable for the losses that result from collateral that is transformed for the customer.	Change made. The CP clarifies that investment losses relate only to investments made by a regulated clearing agency or clearing intermediary using customer collateral, not to the collateral that is transformed for a customer.
	One commenter suggested that the Model Rule allow any investment losses incurred by a clearing agency to be mutualised and allocated to clearing intermediaries.	Change made. The CP explains that investment losses incurred by a regulated clearing agency may be mutualised and allocated to clearing intermediaries, but not to customers.
s. 10 – Acting as a clearing intermediary		
s. 10	One commenter suggested that a clearing agency should not be required to approve the clearing intermediary's customers. Instead, a clearing agency should be allowed to request information about customers and to refuse access to clearing services to a customer of a clearing intermediary.	Change made. A regulated clearing agency is no longer required to approve indirect intermediaries and customers.
s. 13 – Same		
s. 13	Two commenters requested clarification on what is meant by "prudentially regulated" and "appropriate regulatory authority".	Change made. The CP clarifies that, in Canada, prudential regulation of federally regulated financial institutions is undertaken by the Office of the Superintendent of Financial Institutions. Other regulators that perform prudential oversight include the Investment Industry Regulatory Organization of Canada and certain provincial prudential market regulators, such as the Autorité des marchés financiers in Québec or other local securities regulatory authorities. An appropriate foreign regulatory authority would be one that applies comparable regulatory standards to those applied to Canadian entities.

PART 3: RECORD-KEEPING		
s.16 – Retention of records		
s.16	One commenter requested that this requirement not apply to clearing agencies that are exempt from recognition under s. 147 of the *Securities Act* (Ontario).	No change. Retention of records is a requirement for all regulated clearing agencies and clearing intermediaries falling within the scope of the Instrument. However, substituted compliance may be available. See the substituted compliance section above.
s. 17 – Books and records		
s. 17(4)	One commenter suggested removing the word "market" from "market value" to provide for a wider range of alternatives when calculating customer collateral held.	Change made. The word "market" has been removed to ensure that other accepted types of valuation methodologies can be utilized, where appropriate.
s. 20 – Separate records – derivatives clearing agency		
s. 20	One commenter suggested that the Model Rule should require clearing agencies to keep records of the positions and property of each customer only where the customer is a direct customer of a clearing intermediary, and therefore, identifiable to the clearing agency. The commenter also suggested that the Model Rule should allow clearing agencies to keep records of the positions and property of each clearing intermediary's customers at an aggregate level per clearing intermediary.	No change. Without records for customers clearing through clearing intermediaries, portability would be impeded.
PART 4: REPORTING AND DISCLOSURE		
General Comments	Two commenters expressed concern over confidentiality and public access to the customer collateral reports.	Reports will be treated as confidential by securities regulatory authorities, subject to applicable provisions of the freedom of information and protection of privacy legislation adopted by each province and territory. However, the Committee may share the reports with self-regulatory organizations or other relevant regulatory authorities.

s. 25 – Disclosure to clearing members and customers		
s. 25(4)	Two commenters expressed concern over the requirement to receive written acknowledgements from customers and one of the commenters suggested to either make the disclosure publicly available or incorporate the disclosure into the legal agreements between the parties.	Change made. The requirement to receive written acknowledgements from customers has been removed.
s. 28 – Customer collateral report		
s. 28(3) and s. 28(4)	One commenter requested that this requirement not apply to clearing agencies that are exempt from recognition under s. 147 of the *Securities Act* (Ontario). Another commenter suggested that the requirements under these subsections should not apply to foreign-based recognized clearing agencies and instead they should be permitted to comply by way of substituted compliance.	No change. See the substituted compliance section above. The Committee would consider foreign reporting requirements in our substituted compliance analysis. However, the information contained in the reports is necessary in order for the securities regulatory authorities to fulfill their mandates.
s. 28(5)	One commenter requested clarification on whether the reporting requirement applies in respect of (a) each individual derivatives transaction or an aggregate net exposure for all derivatives transactions for a customer, and (b) each individual type of customer collateral or collateral on an aggregate basis, regardless of collateral type. The commenter also suggested that the Model Rule should be revised to include asset type and quantity (in addition to the market value) of customer collateral that is posted by a clearing intermediary to a clearing agency on behalf of a customer.	Change made. The reporting requirement is intended to be applied in respect of aggregate net exposures for all derivatives transactions of each customer. The Instrument requires clearing intermediaries to report the current value, asset type and quantity of the collateral received.
s. 29 – Disclosure of customer collateral investment		
s. 29(1)	One commenter expressed concern over inadvertently requiring a clearing agency to publicly disclose proprietary information such as its investment guidelines and policies.	Change made. Regulated clearing agencies are only required to disclose their investment guidelines and policies directly to the customer and, if applicable, a direct intermediary.
s. 29(2)	One commenter expressed concern over the onerous requirement to receive written acknowledgements from customers and suggested that disclosure be incorporated into the legal agreements between the parties.	Change made. See response to comments on s. 25(4).

s. 29(3)	Two commenters noted that the timing for submitting the required report is not specified.	Change made. Monthly reporting to securities regulatory authorities on customer collateral is required to be delivered within 10 business days of the end of each calendar month.
PART 5: TRANSFER OF POSITIONS		
General Comments	One commenter noted that a clearing agency may not be in a position to ascertain whether or not a customer is in default and suggested that the provisions of this section be revised to reflect the solvency status of the customer's account (i.e., whether or not the collateral value is sufficient to cover the initial margin obligations).	Change made. The Instrument now provides that a regulated clearing agency and a direct intermediary may facilitate porting of a customer's positions and collateral only where the customer's account is not currently in default.
s. 30 - Transfer of customer collateral and positions		
s. 30(1)	One commenter suggested changing the language of the subsection from "transfer of the customer's positions and customer collateral" to "transfer of the customer's positions and customer collateral or its liquidation proceeds".	Change made. The Instrument now permits transfer of the liquidation proceeds of customer collateral.
	One commenter requested clarification on when a clearing intermediary that is to receive transferred customer positions and collateral, or its liquidation proceeds, provides its consent to the transfer (i.e., if consent would be provided pursuant to arrangements made between parties at the outset of the relationship or concurrently with an event of default).	Change made. Additional guidance has been provided in the CP setting out that it is the Committee's view that such consent for transfer should be obtained at the outset of the clearing relationship.
s. 30(3)	One commenter suggested adding a requirement that conditions (a) to (e) be met within a reasonable time that is to be predetermined by a clearing agency.	No change; however, the Committee has provided additional guidance in the CP with respect to the timing for customers and direct intermediaries to provide consent to a transfer.

List of Commenters:

1. Atlantic Central
2. Caisse de dépôt et placement du Québec
3. Canadian Investor Protection Fund
4. Canadian Life and Health Insurance Association Inc.
5. Canadian Market Infrastructure Committee
6. Capital Power Corporation
7. Central 1 Credit Union
8. Concentra Financial Services
9. Enbridge Inc.
10. ICE Clear Credit LLC
11. IGM Financial Inc.
12. International Swaps and Derivatives Association, Inc.
13. Investment Industry Association of Canada
14. LCH.Clearnet Group Limited
15. NB Investment Management Corp.
16. Pension Investment Association of Canada
17. RBC Global Asset Management Inc.
18. SaskEnergy Incorporated
19. Suncor Energy
20. The Canadian Commercial Energy Working Group
21. TMX Group Limited
22. TransCanada Corp.