

# IIROC NOTICE

## **Rules Notice Request for Comment**

Dealer Member Rules

**Comments Due By: August 16, 2017**

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**17-0110**

**May 18, 2017**

## **Amendments to Dealer Member Rules and Form 1 relating to the futures market segregation and portability customer-protection regime**

### **Executive Summary**

IIROC is proposing amendments to its Dealer Member Rules (**DMRs**) and Form 1 (collectively, the **Amendments**) that are required because of implemented and expected upcoming changes at the two Canadian futures market central clearing counterparties (**CCPs**) – ICE Clear Canada (**ICCA**) and Canadian Derivatives Clearing Corporation (**CDCC**). These CCPs are making changes to comply with the Principles for Financial Market Infrastructures (**PFMI**) published by the Committee on Payments and Market Infrastructures (**CPMI**) and the International Organization of Securities Commissions (**IOSCO**), and adopted by the Canadian



Securities Administrators (**CSA**) and the Bank of Canada (**BOC**).<sup>1</sup> The Amendments refer specifically to changes resulting from Principle 14: segregation and portability (**Seg & Port**).<sup>2</sup>

The primary objective of the Amendments is to codify DMR requirements that restrict linkages between a Dealer Member's futures business and its other business lines that are not subject to the futures market Seg & Port regime.

The Amendments:

- set higher customer margin requirements for futures positions in order to harmonize IIROC futures customer margin requirements with the new CCP Gross Customer Margin (**GCM**) model
- apply stricter criteria in order to use offset margin requirements for customer cross-product hedges between securities positions and futures positions
- eliminate the possibility of customer guarantees between securities accounts and futures accounts
- eliminate the use of a customer's excess margin in the customer's futures account to satisfy a margin deficiency in their securities account, or vice versa
- eliminate the use of customer free credits from securities accounts in the futures business
- require separate ledger accounts and identifiers to distinguish futures accounts and related collateral from other customer accounts.

We based the Amendments on ICCA's segregation and portability model, which was implemented in 2014 and uses GCM. While CDCC has not finalized its model, we expect it will implement a GCM model, similar to ICCA's, in the near future. A GCM model gives the CCP greater resources to port (transfer) customer positions and related collateral of a defaulting CCP clearing participant to another CCP clearing participant than under the current net margining model used by CDCC. These resources, which include daily customer position reporting to the CCP, lessen the CCP's reliance on other stakeholders such as the trustee in bankruptcy and the Canadian Investor Protection Fund (**CIPF**), which may increase the likelihood that porting occurs.

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<sup>1</sup> See NI 24-102 and Related Companion Policy 24-102CP (<http://www.osc.gov.on.ca/en/46657.htm>) and The Bank of Canada's Risk-Management Standards for Systemic FMIs (<http://www.bankofcanada.ca/core-functions/financial-system/bank-canada-risk-management-standards-systemic-fmis/#bankstandards>).

<sup>2</sup> See full PFMI at: (<http://www.bis.org/cpmi/publ/d101a.pdf>).



These CCP rule changes would create a new futures market customer-protection regime that is not entirely consistent with, and adds incremental risk for, the existing IIROC-CIPF customer-protection regime. The question of how the CCPs' segregation and portability models will work with CIPF's customer-protection regime remains to be resolved. In addition, the following significant outstanding matters still need to be resolved:

- the specific model and margin approach that CDCC will implement
- how the CCPs will treat customer excess collateral held at the CCP
- how IIROC will treat customer excess collateral held at the CCP for capital reporting purposes.

Consequently, we plan to take a phased approach to consider and develop proposed amendments as we receive and assess additional information on these outstanding matters. We continue to consult with key stakeholders to address these matters as detailed in subsection 5.2 of this Notice.

### **Impacts**

Dealer Members will need to allocate resources to update their books and records, and supporting systems, to meet the new requirements for futures accounts. The Amendments may require Dealer Members to alter some of their business arrangements with futures customers that also maintain securities accounts.

Most significantly, the Amendments have the potential to affect materially the marketplace. The Amendments may result in higher margin requirements for certain institutional customers, which may significantly affect both unhedged futures trading and cross-product hedge trading involving futures and underlying cash market securities. However, as a mitigating factor, futures market participants should be familiar with the GCM model, which already operates in major futures markets throughout the world.

### **How to Submit Comments**

Comments are sought on the Amendments, including any matter that they do not specifically address. Comments should be made in writing. Two copies of each comment letter should be delivered by August 16, 2017 (90 days from the publication date of this Notice). One copy should be addressed to the attention of:



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The second copy should be addressed to the attention of:

Manager of Market Regulation  
Ontario Securities Commission  
19th Floor, Box 55  
20 Queen Street West  
Toronto, ON M5H 3S8  
[marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

**Those submitting comment letters should be aware that a copy of their comment letter will be made publicly available on the IIROC website ([www.iiroc.ca](http://www.iiroc.ca) under the heading “Rulebook - IIROC Dealer Member Rules - Proposed Policy”).**

Questions may be referred to:

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## 1. Discussion of the Amendments

### 1.1 Principle 14: segregation and portability

In 2014, the CSA published National Instrument 24-102 – *Clearing Agency Requirements (NI 24-102)*, which set the objective to implement the PFMI, including Principle 14, as clearing agency rule requirements in Canada.<sup>3</sup> The PFMI are part of a set of 12 international standards meant to serve as essential underpinnings to strengthen and preserve financial stability.<sup>4</sup> They apply to all systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories.<sup>5</sup>

Principle 14 states that a CCP must have rules and procedures that “enable the segregation and portability of positions of a participant’s customers and the collateral provided to the CCP with respect to those positions.” Principle 14 describes segregation as a method of protecting customer collateral and contractual positions by holding or accounting for them separately. It describes portability as the operational transfer of contractual positions, funds, or securities from one clearing participant to another clearing participant. Effective portability arrangements lessen the need to close out positions, particularly during periods of market stress.<sup>6</sup>

There are four key considerations in complying with Principle 14:

- “A CCP should, at a minimum, have segregation and portability arrangements that effectively protect a participant’s customers’ positions and related collateral from the default or insolvency of that participant. If the CCP additionally offers protection of such customer positions and collateral against the concurrent default of the participant and a fellow customer, the CCP should take steps to ensure that such protection is effective.
- A CCP should employ an account structure that enables it readily to identify positions of a participant’s customers and to segregate related collateral. A CCP should maintain customer positions and collateral in individual customer accounts or in omnibus customer accounts.

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<sup>3</sup> See NI 24-102 and Related Companion Policy 24-102CP (<http://www.osc.gov.on.ca/en/46657.htm>).

<sup>4</sup> See Financial Stability Board (The Compendium of Standards - Financial Stability Board): “Key Standards for Sound Financial Systems”.

<sup>5</sup> PFMI, (<http://www.bis.org/cpmi/publ/d101a.pdf>), pg.5. See also Bank for International Settlements ([www.bis.org/cpmi/info\\_pfmi.htm](http://www.bis.org/cpmi/info_pfmi.htm)): “Principles for Financial Market Infrastructures”, (December 2015).

<sup>6</sup> PFMI, (<http://www.bis.org/cpmi/publ/d101a.pdf>), pg.82.



- A CCP should structure its portability arrangements in a way that makes it highly likely that the positions and collateral of a defaulting participant’s customers will be transferred to one or more other participants.
- A CCP should disclose its rules, policies, and procedures relating to the segregation and portability of a participant’s customers’ positions and related collateral. In particular, the CCP should disclose whether customer collateral is protected on an individual or omnibus basis. In addition, a CCP should disclose any constraints, such as legal or operational constraints, that may impair its ability to segregate or port a participant’s customers’ positions and related collateral.”<sup>7</sup>

## **1.2 Principle 14 and the Canadian futures market<sup>8</sup>**

Principle 14 does not mandate a set of prescriptive requirements for all CCPs to follow. For example, for cash-market clearing, the CSA considers CDS Clearing and Depository Services’ existing continuous net settlement (**CNS**) model already compliant with Principle 14 under an “alternate approach”.<sup>9</sup> In addition, the CSA’s recently implemented Seg & Port regime for the over-the-counter (**OTC**) derivatives market differs from the regime developing for futures markets. Futures market CCPs are mandated to comply with Principle 14, but have not been obligated to meet the CSA’s prescriptive requirements for the OTC derivatives market, notably regarding the segregation standards for customer collateral.<sup>10</sup>

### **1.2.1 GCM model**

The Seg & Port regime outlined by Canadian futures market CCPs requires a form of legal segregation (as opposed to full or physical segregation) supported by a GCM model and daily clearing participant disclosure to the CCP of each customer’s positions. GCM means that the amount of margin that a clearing participant must post to the CCP on behalf of its customers is the sum of the margin required for each of its customers. In contrast, under a net margining model the CCP does not distinguish between each individual customer’s positions within the

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<sup>7</sup> PFMI, (<http://www.bis.org/cpmi/publ/d101a.pdf>), pg.82.

<sup>8</sup> See CSA Staff Notice 24-315 ([http://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20170209\\_24-315\\_enhanced-segregation.htm](http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170209_24-315_enhanced-segregation.htm)).

<sup>9</sup> The PFMI do not contemplate an “alternate approach” for futures markets. See PFMI, (<http://www.bis.org/cpmi/publ/d101a.pdf>), pg. 83.

<sup>10</sup> For details on the OTC derivatives Seg & Port regime, see National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* and Related Companion, ([http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa\\_20170119\\_94-102\\_customer-clearing.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category9/csa_20170119_94-102_customer-clearing.pdf)).



aggregated customer omnibus account and as a result, the CCP offsets the risk of any opposite exposures when it calculates the clearing participant's customer margin requirement.<sup>11</sup>

GCM results in the CCP receiving more customer collateral to support the positions held within the customer omnibus account. Although the CCP will require the Dealer Member to disclose daily each customer's positions to the CCP, the disclosure of the customer's collateral that is used to support each customer's positions will not be required by the CCP.

The CCP requirements for GCM and daily customer position reporting should ensure that the CCP has adequate aggregate collateral and position information to allow for a more rapid porting of customer positions and related imputed<sup>12</sup> collateral value from a clearing participant that is in default to a different clearing participant.

### **1.3 Challenges for the IIROC-CIPF customer-protection regime**

Under the existing IIROC-CIPF regime, CIPF plays an important role, with the insolvent Dealer Member's trustee in bankruptcy, in facilitating the porting of customer account positions and collateral held at the CCP to another clearing participant. CIPF is concerned that the full implementation of a Seg & Port regime at CDCC and ICCA will restrict the activities of CIPF and/or the trustee in bankruptcy in the administration of a failed Dealer Member that is also a CCP clearing participant and introduce risks to the failed Dealer Member's customer pool.

Although the CCPs already have rules that allow them to port customer positions, they are limited in their ability to port because they have insufficient beneficial customer information under the net margining model to do so. As a result, in a default scenario they must reach out to other stakeholders, such as CIPF and the insolvent Dealer Member's trustee in bankruptcy, to determine the needed customer information to port. GCM gives the CCP this information directly, "thus limiting the need to involve other parties in that determination."<sup>13</sup> Moreover, CDCC's current PFMI disclosure document states that the *Payment Clearing and Settlement Act* (Canada) supports the CCP's rights and remedies regarding margin collateral provided to it, and protects against "interference from any law relating to bankruptcy or insolvency".<sup>14</sup>

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<sup>11</sup> PFMI, (<http://www.bis.org/cpmi/publ/d101a.pdf>), pg.84.

<sup>12</sup> The futures market CCPs' Seg & Port regime model presented to IIROC makes no assurance that protection is provided on a customer-by-customer basis to excess margin collateral deposited at the CCP.

<sup>13</sup> CDCC's PFMI Disclosure Framework Document (December 31, 2016) ([http://www.cdcc.ca/cdcc\\_qld/CDCC\\_Qualitative\\_Disclosure\\_20161231.pdf](http://www.cdcc.ca/cdcc_qld/CDCC_Qualitative_Disclosure_20161231.pdf)), pg.43.

<sup>14</sup> CDCC's PFMI Disclosure Framework Document (December 31, 2016) ([http://www.cdcc.ca/cdcc\\_qld/CDCC\\_Qualitative\\_Disclosure\\_20161231.pdf](http://www.cdcc.ca/cdcc_qld/CDCC_Qualitative_Disclosure_20161231.pdf)), pg.11.





### **1.3.1 Dealer Member integrated futures and securities business lines**

The structure of IIROC futures account rules reflects the IIROC-CIPF customer-protection regime, which covers both securities accounts and futures accounts. Similarly, the structure of Dealer Members' business operations also reflects this integrated model. The customer-protection benefits of the CCPs' GCM model are not entirely consistent with the existing IIROC-CIPF customer-protection regime. The GCM Seg & Port regime model carves out and protects only a customer's futures positions and related collateral value held at the CCP. Carving out and protecting only one type of product held within an integrated business operation and customer-protection regime could have consequences and create unintended risk.

### **1.3.2 Risk-based margin requirements premised on control**

IIROC margin rules allow margin relief for qualifying cross-product hedges involving futures contracts and underlying cash market securities (also referred to as underlying securities). A premise for allowing reduced margin is that the Dealer Member has control of the offsetting positions and is able to reduce the risk of the combined positions accordingly. If a Dealer Member becomes insolvent, the trustee in bankruptcy administering the failed Dealer Member's estate must also have control of both sides of the hedge to offset the risk. GCM increases the probability that the futures contract part of the hedge is ported beyond the control of the insolvent Dealer Member's trustee in bankruptcy. Significant risk to the estate may result where the hedge is broken in this way. The estate will have only the cash market security with insufficient margin to support an unhedged risk profile.

### **1.3.3 GCM and funding drain**

IIROC margin rules for cross-product hedges, as well as reduced margin requirements for institutional customers that qualify as "acceptable institutions", "acceptable counterparties" and "regulated entities" under IIROC's rules, may result in a lower margin requirement for these customers than the amount of corresponding margin the Dealer Member must post at the CCP.<sup>15</sup> Under the IIROC-CIPF regime, Dealer Members can fund this gap with their own capital or with eligible assets from other customers, such as free credit balances. Currently, this

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<sup>15</sup> Although the IIROC rules allow preferential margin treatment for these classes of institutional customers, Dealer Members may also require higher "house margin rates" for futures contract positions that are similar to the CCP margin requirements. The futures exchanges also have rules in place that may require participants (i.e. IIROC Dealer Members) to collect from their customers at least the minimum margins required by the exchange or CCP (see ICCA Rule 4E.05 and Bourse de Montréal Rule 9121(f)).



type of funding gap is not a concern because CIPF covers futures accounts and maintains an element of control in the porting process.

More significantly, the CCPs' net margining model typically results in the Dealer Member collecting more margin from its customers than the amount it must post at the CCP. GCM reverses this relationship, creating potential funding drain issues for the Dealer Member. In this context, funding drain refers to the use of Dealer Member capital and/or other eligible non-futures customer assets to satisfy futures customer CCP margin requirements. CCP margin requirements that are greater than IIROC customer margin requirements could lead to funding drain concerns under a GCM model. The GCM Seg & Port regime increases the risk that the CCP would be able to port collateral funded by the Dealer Member or non-futures customers for the benefit of futures customers.

#### **1.3.4 Significant operational issues with portability**

Currently, there may be significant operational issues with the features of the proposed CCP futures market portability model. For instance, although the GCM model requires individual customer position disclosures to calculate margin requirements, it does not necessarily require a corresponding level of detail for the individual customer's collateral (or collateral value) for segregation. CCPs will hold customer collateral in an aggregated account, where collateral is not identified on a customer-by-customer basis.

The CCP daily calculations will simply provide the overall imputed collateral value needed to support the overall disclosed margin positions. As a result, if the CCP ports customer positions and related collateral, any customer with excess margin collateral deposited at the CCP may have this excess ported to the account of a different customer at the receiving Dealer Member. In addition, given CIPF's uncertain role in the porting process, there is uncertainty regarding potential claims on the CIPF investor protection fund if the CCP liquidates positions. Under this framework, we are uncertain about which customer-protection regime (i.e. the CCP Seg & Port regime or IIROC-CIPF regime) will be responsible for potential losses, or assist in correcting any porting misallocations.

We are reviewing the issue of customer excess collateral held at the CCP, and we are considering additional measures to address this issue. This may include requiring capital charges for customer excess collateral held at the CCP. However, we believe that additional information and disclosures from CIPF and the CCPs are also required in order for IIROC to do a proper risk assessment of these issues as detailed in subsection 2.1 Issues and alternatives considered.



## 1.4 Current rules: a phased approach to rule amendments

We reviewed the DMRs and Form 1 to assess futures accounts, the linkages between futures accounts and securities accounts, and corresponding references to CIPF. Appendix B provides a comprehensive list of DMRs that could be impacted by the Seg & Port regime. The Amendments address the immediate issues raised by the CCP adoption of the GCM model.

There are challenges involved in proposing rule amendments while changes to the Seg & Port regime and its impact on the existing IIROC-CIPF customer-protection regime are still in flux. As a result, our rule development process will follow a phased approach. We will propose additional amendments as needed to address identified risks as the Seg & Port regime develops.

The Amendments focus on the primary issues and related rules to address futures account risks in the table below.

#	Issue	Current DMRs impacted by the Amendments
1.	GCM at the CCP	<ul style="list-style-type: none"> <li>• Rule 100.8(a) <i>Commodity Futures Contracts and Futures Contract Options</i></li> <li>• Schedule 4 (Analysis of Clients' Trading Accounts Long and Short) and notes and instructions</li> <li>• Schedule 5 (Analysis of Brokers' and Dealers' Trading Balances) and notes and instructions</li> <li>• Rule 1200.1 <i>Clients' Free Credit Balances</i></li> <li>• Rule 1800.1 <i>Commodity Futures Contracts and Options ("Omnibus Account")</i></li> </ul>
2.	Excess customer collateral held at the CCP	<ul style="list-style-type: none"> <li>• Rule 100.15 <i>Guarantees</i></li> <li>• Rule 1800.9 <i>Commodity Futures Contracts and Options</i></li> <li>• Rule 1800.10 <i>Commodity Futures Contracts and Options</i></li> </ul>
3.	Dealer Member record-keeping	<ul style="list-style-type: none"> <li>• Rule 200.2(c) <i>Itemized client ledger accounts</i></li> </ul>

## 1.5 Proposed rules: a phased approach to rule amendments

We categorized the Amendments according to the corresponding issue addressed. Appendix A provides a text of the Amendments, which are black-lined to show the changes to the current rules.

We have also proposed two other general changes:



- to add the definition of “Commodity Futures Segregation and Portability Customer Protection Regime” to Rule 1.1 *Interpretation and Effect*
- to add a reference to Ontario Securities Commission Rule 14-502 (Commodity Futures Act) *Designation of Additional Commodities* to the definition of “commodity” in Rule 1800.1.

We use the proposed definition in Rule 1.1 throughout the Amendments to distinguish the Seg & Port regime from a Dealer Member’s securities-related business. The reference to the OSC rule clarifies that the scope of the term commodity includes financial futures.

### **1.5.1 GCM at the CCP**

#### **Rule 100.8(a) Commodity Futures Contracts and Futures Contract Options, Schedule 4 (Analysis of Clients’ Trading Accounts Long and Short) and notes and instructions, and Schedule 5 (Analysis of Brokers’ and Dealers’ Trading Balances) and notes and instructions**

We amended Rule 100.8(a) to change the minimum regulatory margin requirement for customers to the greatest of:

1. the IIROC margin requirement
2. the futures exchange margin requirement
3. the CCP margin requirement
4. the clearing broker’s margin requirement.

This change is required to address funding drain concerns. The CCP’s GCM requirement must not be greater than the margin amount the IIROC Dealer Member collects from its customers. It would restrict the use of either Dealer Member capital or assets of other non-futures customer (i.e. free credits) to fund higher CCP margin posting requirements. The margin collected from the futures customer should flow through to the CCP to collateralize the customer’s futures position obligation.

We amended Schedules 4 and 5 of Form 1 to ensure that the “greatest of” concept also applies to acceptable institutions, acceptable counterparties and regulated entities. These institutional customers currently benefit from preferential regulatory margin requirements compared to retail customers because of their lower counterparty credit-risk status, as detailed in Form 1<sup>16</sup>.

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<sup>16</sup> Institutional clients refer to Acceptable Institutions (AIs), Acceptable Counterparties (ACs) and Regulated Entities (REs) as defined in the General notes and definitions of Form 1. Margin



These changes may have a material impact on these institutional customers because they represent an increase in their current minimum regulatory margin requirements.

We analysed current industry practice for institutional futures business and recommend a longer grace period for Dealer Members to collect margin in comparison to retail customers. The proposed changes for acceptable institutions, acceptable counterparties and regulated entities accounts require Dealer Members to report capital charges for margin deficiencies on the second business day following the day the account is undermargined. This proposed change is similar to existing U.S. requirements under CFTC Regulation 1.17(c)(5)(viii)-(ix). We did not propose a change to the current capital charge reporting schedule related to retail customers.

We also amended Rule 100.8 and Schedules 4 and 5 to restrict cross-product hedge margining. As indicated above, cross-product hedges involving futures contracts and underlying cash market securities pose risks under a Seg & Port regime. At the same time, we do not want to eliminate the possibility for reduced hedge margining, which may negatively affect trading activity and liquidity. For these reasons, we have amended the rules to prohibit margin relief for these cross-product hedges unless the customer signs a hedge agreement recognized by the CCP and acceptable to IIROC.

We believe margin relief for cross-product hedges should only apply where each part of the hedge is subject to the same customer-protection regime. The CCP will need to recognize the hedge and take delivery of the underlying cash market instrument(s) supporting the futures contract(s). The CCP must be able to separately identify, segregate, and link the cash market collateral to the futures positions for the beneficial customer. In a porting event, our expectation is that the futures contract(s) and underlying cash market instrument(s) supporting the hedge would port together.

#### **Rule 1200.1 Clients' Free Credit Balances**

We amended Rule 1200 to prohibit specifically the use of non-futures customer free credits to secure futures market CCP deposit requirements. This proposed rule change supports the other Amendments needed to address funding drain.

#### **Rule 1800.1 Commodity Futures Contracts and Options ("Omnibus Account")**

We deleted the definition of "Omnibus Account" to avoid confusion because the definition does not describe a GCM omnibus account model. The current definition refers to an account

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requirements for these customers are detailed in the notes and instructions to Schedules 4 and 5 of Form1.



structure where the Dealer Member does not disclose the identity of the individual customers comprising the account. Under a GCM omnibus account model, the Dealer Member would disclose the identity of the individual customers to the CCP.

### **1.5.2 Excess customer collateral lodged at the CCP**

#### **Rule 100.15 Guarantees**

The elimination of account guarantees that cross between futures accounts and securities accounts is necessary to separate, and allow the co-existence of, these account types within the same Dealer Member. The Amendments to Rule 100.15 prohibit guarantees between Seg & Port regime futures accounts and securities accounts. This will eliminate the possibility of netting balances between these account types for calculating margin requirements. This ensures that any excess customer collateral held at the futures market CCP has no regulatory value for securities account margining purposes. This change is required because a futures customer's excess collateral held at the CCP may not be returned to the trustee in bankruptcy for the insolvent Dealer Member, even if the customer has other securities accounts or guaranteed obligations with the insolvent Dealer Member that are under-margined.

#### **Rules 1800.9 and 1800.10 Commodity Futures Contracts and Options**

We amended Rules 1800.9 and 1800.10 to ensure that the proposed account guarantee restriction also applies to situations where the same customer has both a futures account and a securities account. The futures account trading agreement defines rights and obligations between the Dealer Member and the customer. The amendments to Rules 1800.9 and 1800.10 require the futures trading account agreement, or in some cases, a letter of undertaking or comparable document, to define the rights and obligations regarding margin netting arrangements between futures and securities accounts in accordance with proposed Rule 100.15(a).

To summarize, the account guarantee restrictions and related changes to the futures trading account agreement promote the flow-through of futures customers' margin collateral to the CCP. In addition, they ensure that customer excess margin collateral held at the futures market CCP is not used for margin purposes in a securities account.

### **1.5.3 Dealer Member record keeping**

The proposed separate record-keeping requirement in Rule 200.2 provides the accounting groundwork to separate the linkages between futures and securities accounts. Dealer Members must be able to separate and clearly identify the accounts, positions, and related collateral of futures accounts that are subject to a Seg & Port regime. We believe that most Dealer Members



that are active in both futures and securities markets already have the systems in place to satisfy this requirement.

## **2. Analysis**

### **2.1 Issues and alternatives considered**

As detailed in this Notice, we are pursuing a phased approach to develop policy in response to the developing futures market Seg & Port regime changes. The following outstanding matters still need to be resolved:

- the specific model and margin approach that CDCC will implement
- in the event of a default of a Dealer Member that is also a CCP clearing participant, how ICCA's and CDCC's segregation and portability models will work with the IIROC-CIPF customer-protection regime
- how the CCPs will treat customer excess collateral held at the CCP
- how IIROC will treat customer excess collateral held at the CCP for capital reporting purposes
- whether CIPF will continue to cover futures accounts.

In addition, greater clarity is required from CIPF, the CCPs, and the CSA regarding other fundamental aspects of the Seg & Port regime, such as:

- whether there will be an information-sharing protocol or Memorandum of Understanding (MOU) between CIPF and the CCPs
- whether amendments to standard risk disclosure statements prescribed by provincial securities, derivatives or commodity futures legislation will occur in order to make the Seg & Port regime more transparent to a futures customer.

We considered the following two alternatives:

- to wait until the futures market Seg & Port regime is fully defined and implemented, including how it will work with the CIPF-IIROC regime, and then develop and propose a more complete set of amendments
- to proceed with a phased approach to policy development, where we would develop and propose amendments in phases as we receive and assess the necessary additional information that provides clarity on the above outstanding matters from the key stakeholders.



We chose the phased approach because the risks identified under the GCM model are already present today, and expected to increase when CDCC implements the model in the near future. We recognize that Dealer Members will require some time to make the operational changes because of the Amendments, and we do not want to delay this process. Finally, we believe that by making transparent some of the issues and concerns raised in this Notice we will help engage key stakeholders to work together to ensure the customer-protection regimes function in a coordinated manner that treat all Dealer Member customers fairly.

## **2.2 Comparison with similar provisions**

Canada is committed to meet the PFMI's international standards.<sup>17</sup> The CSA requirements for CCPs reflect this commitment. Practically speaking, meeting these standards are necessary because the major trading markets are conforming to the PFMI, and there is the risk that non-compliant jurisdictions will lose international trading links and volume. The applicability of the PFMI extends to those jurisdictions with authorities that are members of the Financial Stability Board or CPMI-IOSCO's PFMI Steering Group. These jurisdictions include the major markets for futures trading.<sup>18</sup>

It is inevitable that Canada's futures market CCPs will make the changes to comply with Principle 14. The Amendments will harmonize IIROC's rules with the CCPs' move to GCM, which is a key feature of their Seg & Port regime model. However, Canada's futures market differs from other jurisdictions because there is CIPF coverage for customer futures accounts. We are not aware of any other jurisdiction with a similar customer protection fund covering both customer futures accounts and customer securities accounts.

## **3. Impacts of the Amendments**

It is clear that the framework for the Seg & Port regime will affect the existing IIROC-CIPF customer-protection regime. The IIROC-CIPF regime covers futures accounts and securities accounts as integrated parts of its customer protection model. The CCPs' new potential ability to more rapidly port futures customer positions and collateral calls into question CIPF's and the trustee in bankruptcy's current role in administering futures account positions and collateral in a CCP clearing participant's insolvency. The Amendments will impose necessary separation

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<sup>17</sup> See Implementation monitoring of PFMI: Third update to Level 1 assessment report (June 2016), (<http://www.bis.org/cpmi/publ/d145.pdf>), pp. 7-9.

<sup>18</sup> See Bank for International Settlements ([http://www.bis.org/cpmi/info\\_mios.htm?m=3%7C16%7C599](http://www.bis.org/cpmi/info_mios.htm?m=3%7C16%7C599)) (Monitoring the implementation standards (August 2016)).





between futures and securities operations, which we believe will benefit all stakeholders at this stage.

The greatest potential impact from the Amendments results from the CCPs' changing from a net-customer-margining model to a GCM model. GCM will result in a larger customer collateral requirement at the CCP. The Amendments promote the flow-through of this higher collateral requirement from the futures customer to the CCP. The account guarantee restriction may require Dealer Members to alter some of their business arrangements with futures customers that also maintain securities accounts.

Most significantly, GCM has the potential to affect materially the marketplace. The Amendments may result in higher margin requirements for institutional customers that qualify as acceptable institutions, acceptable counterparties and regulated entities, which may significantly affect both unhedged futures trading and cross-product hedge trading involving futures and underlying cash market securities. Mindful of this potential impact, we determined that the proposed margin requirements for these institutional customers should not impose a pre-funding requirement, which is not reflective of current trading practice, and may create additional impacts for these customers and the marketplace. Instead, we proposed a longer grace period for collecting margin from these institutional customers compared to retail customers. The proposed timeframe for institutional customers to remit margin to the Dealer Member aligns with U.S. requirements<sup>19</sup>. We also left the way open for cross-product hedges to receive margin relief if the CCP recognizes the hedge and holds the component parts in an acceptable form of custody.

The Amendments do not permit unfair discrimination among customers, issuers, brokers, dealers, members or others. They do not impose any burden on competition that is not necessary or appropriate in furtherance of the above purposes.

Additional impacts may result from the implementation of the Seg & Port regime that does not result from these Amendments. For example, smaller Dealer Members have raised concerns that the elimination of CIPF coverage for futures accounts would affect their ability to compete against larger Dealer Members.

#### **4. Implementation**

Dealer Members will need to allocate resources to update their books and records, and supporting systems, to meet the new requirements for futures accounts. This process should

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<sup>19</sup> See subsection 1.5.1. GCM at the CCP. This proposed change aligns with U.S. requirements under CFTC Regulation 1.17(c)(5)(viii)-(ix).



be eased somewhat because many Dealer Members have the systems in place for separate futures account record-keeping. In addition, stakeholders are familiar with the GCM model, which already operates in major futures markets, including Canada's ICCA. CDCC's Seg & Port regime is still under development with implementation expected in the near future.

We will implement the Amendments upon approval by the recognizing regulators within a reasonable period, and in coordination with related developments at the Canadian futures market CCPs.

## **5. Policy Development Process**

### **5.1 Regulatory purpose**

We intend the Amendments to:

- establish and maintain rules that are necessary or appropriate to govern and regulate all aspects of IIROC's functions and responsibilities as a self-regulatory entity
- foster cooperation and coordination with entities engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities
- promote the protection of investors.

### **5.2 Regulatory process**

The Board of Directors of IIROC (**Board**) has determined the Amendments to be in the public interest and on March 29, 2017 approved them for public comment.

We developed the Amendments and consulted with CSA staff (including the NI 24-102 Committee), staff from CIPF, CDCC and ICCA, IIROC's Financial Administrators Section (**FAS**) policy advisory committees, and FAS Futures Market Segregation and Portability Working Group. The consultation process with these key stakeholders is ongoing, given that the Canadian futures market Seg & Port regime is still under development.

After considering the comments on the Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, IIROC may recommend revisions to the applicable proposed amendments. If the revisions and comments received are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the Amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions or comments are material, we will submit the



Amendments including any revisions to the Board for approval for republication or implementation as applicable.

## **6. Appendices**

[Appendix A](#) - Black-line comparison of the Amendments to current DMRs and Form 1

[Appendix B](#) - Comprehensive list of current DMRs that could be impacted by the Seg & Port regime

[Appendix C](#) - Black-line comparison of the plain language version of the Amendments to the most recently published proposed plain language rules.