

## CSA STAFF NOTICE 91-304

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

## 1. 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.

## 2. 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 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.

## 3. 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

<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.

<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*.

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.

#### **4. 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 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.

#### **5. 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.

#### **6. 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)).

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)

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

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:

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### Questions

Please refer your questions to any of:

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**January 16, 2014**