IIAC ACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Dear IIROC and OSC,

Re: Request for Comments – Proposed Amendments to the IIROC Rules and Form 1 relating to the futures segregation and portability customer protection regime

The Investment Industry Association of Canada (the "IIAC") and its members would like to take this opportunity to express their views on the Investment Industry Regulatory Organization of Canada's ("IIROC") Request for Comments regarding the amendments to the IIROC Rules and Form 1 relating to the futures segregation and portability customer protection regime as per IIROC Notice 21-0113 (the "Notice") issued on July 8, 2021.

The IIAC is the national association representing the position of 116 IIROC-regulated dealer member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

Executive Summary - Futures Segregation and Portability Customer Protection Regime

IIROC Notice 21-0113 states the following:

> *The Proposed Amendments are required to align our requirements with expected rule changes at the Canadian Derivatives Clearing Corporation (CDCC), intended to meet international standards for the protection of clients in the event of a default of a clearing participant. CDCC is proposing a new customer protection segregation and portability (Seg and Port) regime to comply with the international standards.*

The IIROC Proposed Amendments would

- *require disclosure to clients on the risks, benefits, conditions and requirements of porting futures contracts and futures contract option positions (collectively, "futures positions") to a replacement Dealer;*
- *require daily records to identify and distinguish Gross Client Margin (GCM) futures positions and related collateral from other positions and accounts;*
- *set higher margin requirements for institutional client futures positions and allow use of SPAN margining to harmonize IIROC futures client margin requirements with the new CDCC GCM model;*
- *apply stricter criteria to continue to qualify for reduced margin for client cross-product hedges between futures positions and underlying securities; and*
- *eliminate the possibility of client guarantees and use of client excess margin between futures accounts and non-futures accounts.*

Furthermore, the Notice continues with the following:

> *We anticipate the Proposed Amendments will benefit Dealers, clients and other stakeholders as they would:*

- *enhance segregation and portability protections offered by CDCC, while maintaining investor protection within the IIROC-CIPF regime, and*
- *align margin requirements with futures exchange and clearing corporation requirements for consistency among client types.*

Industry Position

IIAC members have the following comments and questions:

- **1.5 Details of the Proposed Amendments - 1.5.1 Disclosure to Clients**

  Notice states: *CDCC has proposed rule amendments that would require clearing members to inform clients of the requirements for porting. We believe it is important for clients to understand the risks and benefits associated with any Seg and Port regime that may impact portability of their futures positions.*

  Industry comments: Given the complexity of the proposed amendments, we believe that IIROC and the CDCC should draft the disclosure language to be communicated to clients on porting. Furthermore, as it relates to the availability of a replacement participant Dealer, it should be noted that porting in a short time frame will present challenges for our members, due to extensive regulatory requirements, such as capital requirements and Know-Your-Client requirements.

- **1.5 Details of the Proposed Amendments - 1.5.3 Margin Requirements**

  Notice states: *We amended section 5790 and the notes and instructions to Schedule 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 clients currently benefit from preferential regulatory margin requirements compared to retail clients because of their lower counterparty credit-risk status, as detailed in Form 1. These changes may have a material impact on these institutional clients because they represent an increase in their current minimum regulatory margin requirements.*

  Industry comments: Our members request further clarification on "represent an increase in their current minimum regulatory margin requirements".

  Notice states: *We analysed current industry practice for institutional futures business and recommend a longer grace period for Dealers to collect margin in comparison to retail clients. The proposed changes for acceptable institutions, acceptable counterparties and regulated entities accounts require Dealers to report the margin deficiency in risk adjusted capital unless the margin call is received within one business day of the deficiency occurring.*

  Industry comments: Our members have two questions with respect to unallocated trades: Are unallocated trades granted a grace period for margin calls? Are unallocated trades eligible for additional grace periods to allow firms to search for the rightful owners of the trades?

  Our members also have the following comments and questions: Please define "grace period" as a function of trade date (i.e., margin call is typically made and received on trade date "+1"). Does the grace period extend the margin call to trade date "+2"? Does the grace period extend to what is owed to the CDCC? How does the grace period align with the margin call received from the CDCC? Members believe that, in general, both dates should be in line. Members are therefore seeking clarity on how the CDCC margin call on "T+1" or "T+2" would align with the grace period for the respective margin call. Will there be a mechanism to indicate when a specific margin call requires grace?

- **2 Analysis - 2.1 GCM and funding drain**

  Notice states: *Funding drain exists under the current IIROC margin rules due to the lower margin requirements for certain institutional clients. Reduced margin requirements for cross-product hedges and institutional clients that qualify as "acceptable institutions", "acceptable counterparties" and "regulated entities" under IIROC's rules, may result in a lower margin requirement for these clients than the amount of corresponding margin the Dealer must post at the Central Clearing Counterparty (CCP).*

  Industry comments: Members are requesting further clarity: Which IIROC rules permit these entities to have a lower margin requirement? Are there more than those detailed in Form 1?

Canadian Derivatives Clearing Corporation (CDCC) Amendments - Gross Client Margin Regime and Related Margining

On the same topic, the CDCC issued Notice to Members No 2021-102 on July 5, 2021– its own Request for comments – Amendments to the Rules, Operations Manual, Risk Manual and Default Manual of the Canadian Derivatives Clearing Corporation to Introduce the Gross Client Margin Model.

IIAC members do not have comments at this time, other than concerning the implementation timeline believed to be unrealistic.

<u>Montreal Exchange Request for Comments - Amendments to Article 9.4 of the Rules of Bourse de Montréal Inc. – SPAN Methodology for Client Account</u>

On July 5, 2021, the Montreal Exchange issued Circular 124-21, a Request for Comments on SPAN margining.

Despite multiple conversations, consultations and industry comment letters on this complex topic over the years, questions remain from industry members. Below are the comments and questions submitted to the Montreal Exchange on August 24, 2021. We believed IIROC should be made aware of these concerns.

- **III. ANALYSIS – b. Objectives**

  <u>Circular states:</u> *Complying with principle 14 of the Principles for financial market infrastructures (PFMI) on segregation and portability, CDCC is amending its rules and procedures. CDCC is proposing to i) introduce a GCM Regime applicable to all open positions on Futures and Options on Futures, excluding Hedge Open Positions, and ii) modify related margin requirements for certain accounts.*

  <u>Industry comments:</u> We would request an expanded definition on "Hedge Open Positions" and "certain accounts".

  <u>Circular states:</u> *Allowing the use of Standard Portfolio Analysis of Risk (SPAN) Methodology to calculate margin for Client Accounts within the new GCM Regime would align the margin calculation for clients at both the Canadian Approved Participant of the Bourse and Clearing Member of CDCC levels, if the Approved Participant selects the use of SPAN methodology to calculate margin for their Client Accounts.*

  <u>Industry comments:</u> Will MX, TMX or CDCC send a daily statement with the SPAN calculations (by account) for firms to reconcile? What would constitute a Non-GCM regime? Clarity is required on Hedge Open Positions and Short Positions in Futures or Options where the GCM regime uses SPAN methodology.

- **III. ANALYSIS – d. Analysis of Impacts - iv. Impacts on Clearing Functions & on Trading Functions**

  <u>Circular states:</u> *For instance, for share futures contracts (under hedge accounts) and equity options with the same underlying, Approved Participants would continue to margin client portfolio exposures using the strategy-based method.*

  <u>Industry comments:</u> Do single stock futures fall into the category of "Hedge Open Positions"? Would clients who only hold share futures contracts be considered to be under a Non-GCM regime?

<u>Timing for implementation</u>

Industry members believe that the timeline to implement the changes to the systems and related technology must be sufficient. CDCC Notice to Members No 2021-102 mentions a single implementation expected in the second quarter of 2022. This timeline is unrealistic for industry members.

Conclusion

As stated above, questions remain regarding the move to a segregation and portability regime in Canada and regarding the use of SPAN methodology for client accounts.

Please note that the IIAC and its members, as always, remain available for further consultations.

Yours sincerely,

Investment Industry Association of Canada