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Me Philippe Lebel
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Dear Me Brault and Me Lebel:

Re: Request for Comments – Amendments to Article 9.4 of the Rules of Bourse de Montréal Inc. – SPAN methodology for client account

The Investment Industry Association of Canada (the "IIAC") and its members would like to take this opportunity to express their views on the Bourse de Montréal Inc. (the “Bourse”) Request for Comments regarding the amendments to Article 9.4 of the Rules of the Bourse in order to permit the use of the Standard Portfolio Analysis of Risk (“SPAN”) methodology to determine margin requirements for futures and options on futures as per Circular 124-21 (the “Circular”) issued on July 5, 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.

We remind Bourse de Montréal Inc. that this comment letter, in its entirety, can be published on the Bourse’s website.

Amendments – Description and Objectives

Circular 124-21 includes the following:

> *Bourse de Montréal Inc. (the "Bourse") and the Regulatory Division (the "Division") of the Bourse propose to modify the Rules of the Bourse (the "Rules") to permit the use of the Standard Portfolio Analysis of Risk ("SPAN") methodology to determine margin requirements for futures and options on futures with respect to a Client Account under circumstances further described in this analysis. The Canadian Derivatives Clearing Corporation ("CDCC") is introducing a Gross Client Margin Regime ("GCM Regime") consistent with the regulatory requirements under the Principles for Financial Market Infrastructures ("PFMI"). Applying SPAN methodology for Futures and Options on Futures to a Client Account under the GCM Regime, would increase transparency and alignment with global industry standards, thereby reducing uncertainty between different margin calculation methods.*
>
> *[…]*
>
> *The Bourse and the Division are proposing amendments to Article 9.4 to permit the optional use of SPAN methodology for Client Accounts under the GCM Regime to calculate margin requirements for Futures and Options on Futures.*

The Circular further mentions the following:

> *Complying with principle 14 of the 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. The margin requirement calculation methodology, set out in the Risk Manual of the CDCC, will be updated accordingly.*
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> *As stated, Article 9.4 of the Rules of the Bourse permits the use of SPAN methodology for Approved Participants accounts but prohibits the use of SPAN for Client Accounts. Therefore, the margin that CDCC charges a clearing Approved Participant ("Clearing Member") is established by applying the SPAN methodology. However, Approved Participants are not allowed to use SPAN methodology to determine margin for their clients, regardless of the status of their client. More specifically, if the client of an Approved Participant is another Approved Participant or a Foreign Approved Participant, a non-IIROC member, the SPAN methodology is not permitted to determine margin requirements. As a result, there is a misalignment between the margin charged to the Approved Participant and the one charged to the clients of the Approved Participant.*
>
> *This proposal seeks to amend the Rules to allow for the Approved Participant adoption of SPAN for client margining purposes on targeted Futures and Options on Futures. Allowing the use of 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. Such an approach would achieve operational efficiencies by including any margin relief provided by CDCC which is not currently possible under the dual SPAN and strategy-based regimes.*
>
> *Allowing the optional use of SPAN for Client Accounts would have the added benefits of increased transparency and alignment with global industry standards, thereby reducing uncertainty between different margin calculation methods.*

If the Approved Participant does not select the use of SPAN methodology to calculate client margin, the existing approach, currently published daily by the Division, will continue to apply. Moreover, it is important to note that margin relief between the GCM Regime and the Non-GCM Regime positions will not be permitted by the CDCC in its proposed amendments to the CDCC Rules. Under the GCM Regime, Hedge Open Positions and Short Positions in Futures or Options for which there are deposited Securities held in specific Deposits in accordance with Sections A-212 and A-706 of the CDCC Rules would be excluded.

Industry Position – Questions Remain

Despite multiple conversations, consultations and industry comment letters on this topic over the years, questions remain from industry members.

- **III. ANALYSIS – b. Objectives**

  Circular states: *Complying with principle 14 of the 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.*

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

  Circular states: *Allowing the use of 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.*

  Industry comments: 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**

  Circular states: *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.*

  Industry comments: 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?

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.

Investment Industry Regulatory Organization of Canada (IIROC) amendments - Proposed Amendments to the IIROC Rules and Form 1 relating to the futures segregation and portability customer protection regime

IIROC also published a Request for Comments on July 8, 2021. 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 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.*

We believe the Bourse should be made aware that IIAC members have the following comments (to be submitted to IIROC at a later date):

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

  Circular 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**

  Circular 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".

Circular 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**

Circular 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 CCP.*

Industry comments: Members are requesting further clarity: Can IIROC provide a list of all the rules that permit these entities to have a lower margin requirement?

Timing for implementation

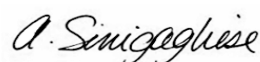
Industry members believe that the timeline to implement the changes to the systems and related technology must be sufficient. CDCC Notice to Members No 2021-102 mentions a single implementation expected in the second quarter of 2022. This timeline is unrealistic for industry members.

Conclusion

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

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

Yours sincerely,



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