IIACACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

RE: Proposed OSC Rule 24-503 Clearing Agency Requirements

The Investment Industry Association of Canada ("IIAC" or "Association") appreciates the opportunity to provide comments on certain aspects of proposed OSC Rule 24-503 – Clearing Agency Requirements (the "Rule" or "Proposal"). The IIAC supports the international work done to establish and implement the Principles for financial market infrastructures (the "principles" or "PFMIs"). The principles will contribute to strengthening core financial infrastructure and markets. Our comments are limited to section 3.14 of the Rule pertaining to segregation and portability.

Section 3.14 of the Rule adopts Principle 14 of the PFMIs requiring all CCPs to have rules and procedures to enable the segregation and portability of positions of a CCP participant's customers and related collateral upon the default or insolvency of the participant. While we support the end objective of the principle, we believe the consultation paper rightly identifies the potential for unintended consequences should it be applied to central counterparties (CCPs) serving markets other than OTC derivatives.

To illustrate, we will reference CDS Clearing and Depository Services Inc. ("CDS") and its Continuous Net Settlement service ("CNS"), Canada's largest cash market CCP. Trades submitted into CNS are netted down by recipient to a single 'buy' or 'sell' position by security and then novated. Imposing a segregation and portability requirement on CNS would essentially require CDS to decompose all the netted trades, impairing any netting and settlement efficiencies from being passed onto its participants as well as the associated risk reductions. CDS would also have to institute significant and costly changes to its margining system in order to margin positions at a gross level. For CCPs without cross-product margining capability, the introduction of "portability" could also potentially result in higher clearing fund margin for legitimate market activity, such as hedges, involving derivative and cash margin positions. Further, CCPs would presumably have to develop a communication mechanism to inform investors of

their collateral/positions in the event of a CCP participant insolvency. The cost of this communication system would also likely be borne by the CCP participants.

The changes at CDS would result in downstream system and procedural impacts at our member firms. Specifically, our members would have to undertake significant reconciliation efforts in order to ensure every CNS trade is client identified along with the client's corresponding collateral. Members post collateral today at CDS which may not be identical to what is posted by the client to the member – which may not even be eligible to post at CDS. This natural disconnect would also have to be addressed by member firms.

The amount of work outlined above on the part of CDS and its CNS participants would essentially be undertaken for the purposes of covering just three days' worth of settlement risk. It is also uncertain whether timely portability could be achieved without corresponding legislative changes requiring the release of client account collateral/positions within a fixed period of time. We do not believe such legislative changes are contemplated in the draft rules and therefore there is no certainty that the introduction of "portability" at CDS would result in more timely access by the investor to their collateral than the current CIPF administered process.

We believe, therefore, a strong position exists in Canada to consider the "alternative approach" Principle 14 offers.

Cash market CCPs operating in Canada, and their participants are subject to a legal and regulatory framework which we believe achieves the same degree of customer asset protection as the approach required by the Principle. Specifically:

a) Customer positions can be identified timely

Securities dealers operating in Canada are subject to oversight by the Investment Industry Regulatory Organization of Canada (IIROC). IIROC Rules require every dealer member to keep and maintain at all times a proper system of books and records necessary to record properly its business transactions including:

> Blotters (or other records of original entry) containing an itemized **daily record** of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all trades in commodity futures contracts and commodity futures contract options, all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was effected, the trade dates and, in the case of trades in securities:
>
> (1) The name, class and designation of securities,
>
> (2) The number, value or amount of securities and the unit and aggregate purchase or sale price (if any), and
>
> (3) The name or other designation of the person from whom the securities were purchased or received or to whom they were sold or delivered;

IIROC also requires that all fully paid or excess margin securities held by a Dealer Member for a client shall be segregated and identified as being held in trust for the client.[1] Furthermore, every Dealer Member must establish and maintain adequate internal controls in accordance with the internal control policy statements in IIROC Rule 2600 including controls pertaining to segregation and safekeeping of client securities.

b) Customers protected by an investor protection plan

The Canadian Investor Protection Fund ("CIPF") has been established by the Canadian investment industry to protect investors in the event of the insolvency of a CIPF Member. CIPF's mandate is to ensure, within defined limits, that the cash and securities belonging to eligible customers of Canadian investment dealers are returned to them as soon as possible. All investment dealer regulated by IIROC are required to be CIPF Members. CIPF, working in conjunction with IIROC and the bankruptcy trustee, ensures the fair and orderly management of customer accounts pursuant to part XII of the Bankruptcy and Insolvency Act (Canada) which sets out the process for dealing with securities firms' bankruptcies. http://laws-lois.justice.gc.ca/PDF/B-3.pdf

c) Customer Assets can be restored

Insolvencies in the Canadian securities industry have not been a common occurrence but the combination of a) and b) above have demonstrated their effectiveness at restoring customer assets when necessary.[2]

We do not believe providing for the "alternative approach" should be equated by the OSC as granting the CCP an 'exemption' from the requirements of Principle 14. An 'exemption' may incorrectly infer internationally that Canadian cash market CCPs are not fully aligned with the PFMI's. Nothing in our reading of Principle 14, and section 3.14.6 in particular, would appear to suggest that cash market CCPs could only avail themselves of the "alternative approach" through some sort of exemptive relief from local authorities.

Thank you for considering our comments.

Sincerely,

"Jack Rando"

Jack Rando
Managing Director
Investment Industry Association of Canada

[1] IIROC Rule 17.2 and 17.3
[2] For Example, measures taken by IIROC and CIPF to protect customers of MF Global Canada http://www.cipf.ca/Libraries/News_Releases/MF_Global_Canada_Co_News_Release.sflb.ashx