CIPF
Canadian Investor Protection Fund

Rozanne E. Reszel, FCPA, FCA, CFA, MBA, ICD.D
President & Chief Executive Officer

T 416 643 7105 **E** rreszel@cipf.ca

VIA EMAIL : comments@osc.gov.on.ca

March 26, 2014

Mr. John Stevenson
The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario M5H 3S8

Dear Sir/Madam,

Re: Request for Comment on Proposed OSC Rule 24-503 Clearing Agency Requirements

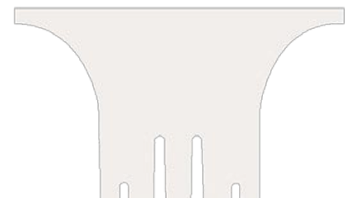
CIPF welcomes the opportunity to comment on the Proposed OSC Rule 24-503 Clearing Agency Requirements ("Rule"). The following are our comments on certain specific questions set out in the request for comments, which are reproduced below in italics and numbered to correspond to the notice.

CIPF previously provided comments in a letter to PFMI Coordinating Group dated June 26, 2013 that remain our views on segregation and portability (copy enclosed). In this letter, we have responded only to Questions 2 and 3 as they are relevant to CIPF's mandate to return customer assets of an insolvency Member.

Question 2: Do you agree with the current drafting approach of section 3.14 of the Rule, i.e., requiring all CCPs to meet Principle 14 in its entirety (without referencing the alternate approach), and granting exemptions on a case-by-case basis to those CCPs for which the alternate approach is appropriate?

CIPF believes Canada has an alternative approach that meets the investor protection requirements of the Principle 14, which are (a) the customer positions can be identified on a timely basis, (b) customers will be protected by an investor protection scheme designed to move customer accounts from the failed or failing participant to another participant in a timely manner, and (c) customer assets can be restored. As this alternative approach is provided for in Principle 14, the drafting should not refer to it as an exemption, which implies a lower standard.

79 Wellington Street West, Suite 610, Box 75
Toronto, Ontario, Canada M5K 1E7
T 416 866 8366 **Toll-Free** 1 866 243 6981
F 416 360 8441 **www.cipf.ca**



Question 3: Should all CCPs serving the Canadian cash market be able to avail themselves of the alternate approach to implementation of Principle 14? How could such CCPs demonstrate that customer assets and positions are protected to the same degree envisioned by Principle 14?

All CCPs servicing the Canadian cash markets should be able to avail themselves of the alternate approach to implementation of Principle 14 if they meet the specific criteria provided in Principle 14 section 3.14.6 which are (a) the customer positions can be identified on a timely basis, (b) customers will be protected by an investor protection scheme designed to move customer accounts from the failed or failing participant to another participant in a timely manner, and (c) customer assets can be restored.

Eligible customers of clearing members of Canadian CCP's that are members of CIPF are protected by CIPF coverage. CIPF coverage extends to all assets held in a customer's account, which includes, securities, cash balances, commodities, futures contracts, segregated insurance funds or other property. Further, Part XII of the Bankruptcy and Insolvency Act ("BIA") is specific bankruptcy legislation for securities dealers that gives priority to the payment of customer claims over general creditors, and ensures clients are treated fairly.

CIPF appreciates the opportunity to provide comments with respect to the Rule and looks forward to discussing these matters further with you as required.

Yours very truly,
CANADIAN INVESTOR PROTECTION FUND

Rozanne Reszel
President & Chief Executive Officer

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Encl.

Rozanne Doc:CSA:CIPF comments-OSC Rule 24-503 Clearing Agency Requirements-140326.docx

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Rozanne E. Reszel, FCA, MBA, CFA, ICD.D
President & Chief Executive Officer

T 416 643 7105 E rreszel@cipf.ca

VIA EMAIL

June 26, 2013

Ms. Antoinette Leung
Manager, Market Regulation
Ontario Securities Commission

and

Mr. Maxime Pare
Senior Legal Counsel, Market Regulation
Ontario Securities Commission
Suite 2000, Box 55, 20 Queen Street West
Toronto, ON M5H 3S8

Dear Antoinette and Max,

Re: CIPF interests with respect to the implementation of IOSCO Principle 14 for Financial Market Structures – Segregation and Portability

Thank you for the opportunity to provide input regarding the implementation of IOSCO Principle 14 for Financial Market Structures – Segregation and Portability.

CSA staff is currently studying the implementation of the segregation and portability aspects of Principle 14. We have met with the CSA staff, as has IIROC staff. There is a decision to be made by the CSA as to whether to implement segregation and portability or demonstrate that sufficient other protections exist in Canada, that it is not necessary.

A paramount objective is the desire to return client assets to the clients' control as soon as possible when a Member firm becomes insolvent. The question arises as to who should undertake that responsibility and what protection should be provided if all the client assets are not available to be returned?

CIPF protection currently commits to protecting client assets that may not be available to be returned from an insolvent member, within defined limits. This is generally done by requesting the court to appoint a trustee under Part XII of the Bankruptcy and Insolvency Act. This federal statute causes the assets of the insolvent member to vest in the trustee who then makes arrangements to transfer them to another member, typically with financial assistance from CIPF.

Clearing corporations are also subject to relevant federal legislation, the Payment and Clearing Settlement Act ("PCSA"), that is designed to protect the solvency of the clearing house. This legislation contains some "notwithstanding" provisions that appear to give

79 Wellington Street West, Suite 610, Box 75
Toronto, Ontario, Canada M5K 1E7
T 416 866 8366 Toll-Free 1 866 243 6981
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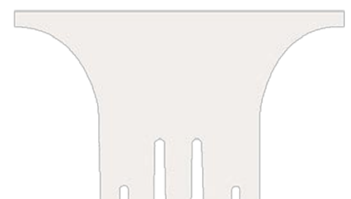

it priority over Part XII. If the clearing corporation has the authority to hold the client assets and the authority to transfer accounts following an insolvency, CIPF cannot commit to also doing the same if the action taken pursuant to the PCSA interferes with assets that have vested in the Trustee. Potentially, CIPF would need to review whether it could provide coverage to certain groups or classes of assets if they were held at the clearing corporation and impacted by the implementation of Principle 14.

Ironically, after getting positive press during the MF Global insolvency about the Canadian regulatory system that regulates all securities, including futures, under one umbrella with a single compensation fund, the potential need to exclude a class of assets from CIPF coverage, moves Canada towards the US model of separate regulation and separate protection of futures.

There are also some operational issues related to the clearing corporation undertaking the responsibility to move client assets. In the first instance, the clearing corporation does not have all the individual client account information, which is held at the Member firm. This information would need to be provided to the clearing corporation and onto the receiving firm in order that client accounts could be set up to receive the cash and securities. The insolvency will likely delay obtaining access to this information by the clearing corporation.

In addition, if a clearing corporation is to be equipped to transfer out client accounts, it must hold all of the related client collateral on a gross basis. Right now, IIROC Members hold the client collateral on a gross basis and provide the clearing corporation with the net collateral. If the gross client collateral is transferred to the clearing corporation, it will impact CIPF if there is an insolvency and the client assets at the clearing corporation don't vest in the Trustee. It will also impact the IIROC Member by reducing the collateral available for use if there is a difference in the margin required by the clearing corporation versus that required by the Member.

The principle of pooling client assets for pro-rata distribution, which is the cornerstone of Part XII of the BIAC, would no longer be applied to all clients if some clients or a portion of the assets of some clients, can be dealt with by the clearing corporation.

The Canadian securities regulatory landscape has demonstrated itself to be robust, with no IIROC firms failing through the 2008 financial crisis. The capital rules and segregation rules are supplemented with monthly financial reporting and Early Warning system that provides IIROC with tools to address a potentially troubled firm early in the process. The generous CIPF coverage limits compliment the pooling approach in Part XII of BIAC.

Moving open futures positions was the single most complex and risky issue related to the MF Global Canada failure. CIPF historically had taken the view that it would close out option and future positions that required daily margin in order to crystallize the client's equity value. Due to the size of MF Global in the US markets, and the potential impact on hedgers and the market impact, the US regulators approved the transfer of open

futures positions with partial collateral. This set the stage to have Canada provide transfers of open contracts as well. However, in Canada clients had the added benefit of CIPF protection that provided full value at the date of transfer to all but 2 large institutional accounts.

Prospectively, clearing corporations could transfer open positions without collateral to reduce market impact. However, only clients who can re-establish new collateral with the receiving Member will avoid being closed out. As a result, the speed of releasing the client collateral from the estate becomes critical. If the clearing corporation takes on the gross collateral and the authority to transfer it, the clearing corporation will have to ensure that the individual client assets are properly reconciled, which is the same work that the Trustee does in the estate. It is not clear what advantage is gained by having the transfer done by the clearing corporation, but it does have an impact on CIPF being able to apply its coverage on the same basis it does today, if all the client assets don't vest in the Trustee. At a minimum, a high degree of coordination would be required.

Members provide clients with statements of securities under their care and custody. Adding the transfer obligation to the clearing corporation introduces the question of whether the assets are under the care and custody of the Member if the clearing corporation takes control in the case of an insolvency.

If CIPF must limit its protection to client assets that are not impacted by potential clearing corporation transfers, the message to clients becomes confusing unless separate accounts are opened for futures and options transactions and related collateral and possibly housed in separate legal entities. At that point, we have truly migrated to the US structure of regulation and investor protection for futures.

CIPF sought legal input from Counsel regarding the interplay of the two relevant federal statues and that information is attached. We look forward to further opportunities to discuss this very important issue.

Yours very truly,

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RR/vl
Encl.