CIPF
Canadian Investor Protection Fund

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VIA EMAIL

March 26, 2014

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Dear Sirs/Mesdames:

Re: Request for Comment on CSA Staff Notice 91-304 – Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral and Positions

The Canadian Investor Protection Fund ("CIPF") welcomes the opportunity to comment on CSA Staff Notice 91-304 – Proposed Model Provincial Rule on Derivatives: Customer Clearing and Protection of Customer Collateral and Positions. Our comments are in addition to the June 26, 2013 letter previously submitted to the PFMI Coordinating Group (copy enclosed). CIPF understands the benefit of centrally clearing Over The Counter ("OTC") derivatives through Central Clearing Counterparties ("CCPs") to increase transparency and reduce risk and shares the objective of protecting client assets.

CIPF cannot currently assess the impact the proposed rules will have on its Members as there has not traditionally been much, if any, OTC derivative activity at Member firms. As this could change, our comments relate to the impact the rules would have assuming some, or all, customers of any insolvent CIPF Member had assets subject to the segregation and portability rules.

CIPF coverage applies only in the event of an insolvency of a Member firm. All IIROC members are automatically Members of CIPF. CIPF coverage ensures that all assets held by a Member for eligible clients are returned within the limits of CIPF coverage. If a Member becomes insolvent, a Trustee is appointed pursuant to Part XII of the Bankruptcy and Insolvency Act ("BIA"), which deals specifically with Securities Dealer insolvency. Part XII provides for the creation of a Customer Pool and General Pool and gives a priority to customers before general creditors. It is a powerful form of protection for investors, providing a fair and efficient means of transferring client accounts. The Trustee distributes assets to all clients on a pro-rata basis, based on the equity in their account. CIPF coverage is applied to any shortfall experienced by an eligible client, after the distribution from the estate. Typically CIPF provides an amount equal to its coverage for all eligible clients to the Trustee so that accounts can be transferred with their equity intact.

If client assets are under the control of the CCP for purposes of portability to another member, they are not available to be placed in the Customer Pool for pro rata distribution to all customers. CIPF coverage cannot apply to assets that are not under the control of the Member and in the event of insolvency, the Trustee. A Trustee relies on the records of the Member to determine the calculation of client net equity prior to calculating the value of the Customer Pool, determining any shortfall of the amount owed to clients and distributing the assets in the Customer Pool on a pro-rata basis. As part of the records, CIPF Members issue statements to their customers identifying all assets they are holding for their behalf and are responsible to return to them. It follows that any assets delivered to the CCP that will not be available to the Trustee to return to clients, should not be recorded as held by the Member in its books and records.

CIPF will continue to monitor the implications of rule developments in this area as they affect its coverage offered to customers of Members.

Yours very truly,
CANADIAN INVESTOR PROTECTION FUND

Rozanne Reszel
President & Chief Executive Officer

RR/vl

Canadian Investor Protection Fund

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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
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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 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,

CANADIAN INVESTOR PROTECTION FUND

Rozanne Reszel
President & Chief Executive Officer

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Encl.