CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice and Request for Comment
Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*
Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives*

February 12, 2015

Introduction

We, the Canadian Securities Administrators are publishing for a 90-day comment period expiring on May 13, 2015:

- Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the **Clearing Rule**), and
- Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives* (the **Clearing CP**).

Collectively, the Clearing Rule and the Clearing CP will be referred to as the "Proposed National Instrument".

We are issuing this notice to provide interim guidance and solicit comments on the Proposed National Instrument.

We would like to draw your attention to the recent publication of Proposed National Instrument 24-102 *Clearing Agency Requirements* and the January 2014 publication of CSA Staff Notice 91-304 *Model Provincial Rule – Derivatives: Customer Clearing and Protection of Customer Collateral and Positions.* These publications, including the Proposed National Instrument, relate to central counterparty clearing and we therefore invite the public to consider these publications comprehensively.

Background

On December 19, 2013, the OTC Derivatives Committee (the **Committee**) published CSA Notice 91-303 *Proposed Model Provincial Rule on Mandatory Central Counterparty Clearing of Derivatives* (the **Draft Model Rule**). The Committee invited public comments on all aspects of the Draft Model Rule. Thirty-four comment letters were received. A list of those who submitted comments, as well as a chart summarizing the comments received and the Committee's responses are attached in Appendix A to this Notice. Copies of the comment letters can be found at http://www.lautorite.qc.ca/en/previous-consultations-derivatives-conso.html.

The Committee has reviewed the comments received and made determinations on revisions to the Draft Model Rule, which has been transformed into the Proposed

National Instrument for the purpose of adopting a harmonized instrument across Canada. A few modifications were made since the last publication, such as including the Bank for International Settlements in the non-application section as well as deleting the requirements for an approval from the board of directors and the agency relationship from the end-user exemption.

The Committee will review all comment letters on the Proposed National Instrument to make recommendations on changes at a Committee level.

Substance and Purpose of the Proposed National Instrument

The purpose of the Clearing Rule is to propose mandatory central counterparty clearing of certain standardized over-the-counter (**OTC**) derivatives transactions, in order to improve transparency in the derivatives market and enhance the overall mitigation of systemic risk.

The Clearing Rule is divided into two rule-making areas: (i) rules relating to mandatory central counterparty clearing for certain derivatives (including proposed end-user and intragroup exemptions), and (ii) rules relating to the determination of derivatives subject to mandatory central counterparty clearing (each a mandatory clearable derivative).

Summary of the Clearing Rule

a) Mandatory central counterparty clearing and end-user and intragroup exemptions

The Clearing Rule provides that a local counterparty to a transaction in a mandatory clearable derivative must submit that transaction for clearing to a regulated clearing agency.

The Clearing Rule provides substituted compliance for transactions involving a local counterparty where the transaction is submitted for clearing pursuant to the laws of a jurisdiction of Canada other than the jurisdiction of the local counterparty or pursuant to the laws of a foreign jurisdiction listed in Appendix B or, in Québec, that appears on a list to that effect. It also provides substituted compliance for a local counterparty in a reliant jurisdiction if the transaction is submitted for clearing to a clearing agency or a clearing house that is recognized or exempted from recognition pursuant to the securities legislation of another jurisdiction of Canada.

Two exemptions to the clearing requirement are provided in the Clearing Rule. The proposed end-user exemption applies when at least one of the counterparties is not a financial entity, as defined in the Clearing Rule, and the counterparty that is not a financial entity is entering into the transaction to hedge or mitigate a commercial risk. The Clearing Rule provides an interpretation of hedging or mitigating commercial risk. There is no requirement to apply for the end-user exemption or to submit any documents to the regulator in order to rely on the exemption.

The proposed intragroup exemption applies, subject to conditions provided in the Clearing Rule, where affiliated entities or counterparties prudentially supervised on a consolidated basis enter into a transaction in a mandatory clearable derivative. A counterparty relying on the intragroup exemption must submit a form to the regulator, identifying the other counterparty and the basis for relying on the exemption.

A counterparty relying on either exemption must document and maintain records to demonstrate its eligibility to rely on the exemption.

b) Determination of mandatory clearable derivatives

A regulated clearing agency is required to notify the regulator of all OTC derivatives or classes of OTC derivatives:

- for which it provides clearing services as of the date of the coming into force of the Clearing Rule, and
- for which it provides clearing services after the date of the coming into force of the Clearing Rule.

After receiving notification by the clearing agency, the regulators will determine whether such cleared derivative or class of derivatives should be made a mandatory clearable derivative.

Our goal is to harmonize, to the greatest extent appropriate, the determination of mandatory clearable derivatives or classes of derivatives across Canada and with international standards.

The Committee is contributing to the work carried out by the OTC Derivative Regulators Group (**ODRG**), which is composed of executives and senior representatives from OTC derivatives regulators in Australia, Brazil, Ontario, Québec, the European Union, Hong Kong, Japan, Singapore, Switzerland and the United States. The Committee's goal is to harmonize the determination process in Canada with the relevant international standards on clearing determinations,[1] which provide for: 1) a framework for consultation among authorities on mandatory clearing determinations, and 2) where practicable, an expeditious review of derivatives that are subject to a mandatory clearing determination in another jurisdiction.

As part of the determination process, we will publish for comment the derivatives we propose to be mandatory clearable derivatives and invite interested persons to make representations in writing. Except in Québec, the determination process is expected to follow our typical rule-making or regulation making process. The list of mandatory clearable derivatives will be included in the Clearing Rule as Appendix A, as amended

[1] This framework is founded on IOSCO recommendations and aims to harmonize mandatory clearing determinations across jurisdictions to the extent practicable and where appropriate, subject to jurisdictions' determination procedures. *See IOSCO Report on Requirements for Mandatory Clearing* (February 2012), available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD374.pdf

from time to time. In Québec, the determination process will be made by decision and the list of mandatory clearable derivatives will appear on a public register kept by the Autorité des marchés financiers.

In assessing whether a derivative or class of derivatives should be a mandatory clearable derivative, we anticipate considering various factors including the standardization of a derivative or class of derivatives, its risk profile, and the liquidity and characteristics of its market in determining whether the derivative or class of derivatives is appropriate for mandatory central counterparty clearing. It is anticipated that derivatives transaction data reported pursuant to local derivatives data reporting rules[2] will provide key information in the determination process.

c) Phase-in of the requirement to clear a mandatory clearable derivative

We expect to follow a phase-in approach with respect to the clearing requirement which would be consistent with the approach taken by the United States and the European Union, and which has been proposed in Australia.

More specifically, we anticipate that the requirement to clear a derivative or class of derivatives that has been determined to be a mandatory clearable derivative would be phased-in across different categories of market participants. Clearing members of a regulated clearing agency that provides clearing for the mandatory clearable derivative at the time its determination becomes effective would be subject to the clearing requirement in the first phase-in category. The second phase-in category would include financial entities above a specified (yet to be determined) threshold. The third phase-in category would include all other financial entities. The fourth and final phase-in category would include all counterparties that are not financial entities.

We are considering granting a cumulative 6-month grace period to each phase-in category except the first category. Hence, counterparties that are not financial entities would benefit from an 18-month grace period after the date the determination becomes effective for the first phase-in category. The Committee asks market participants to comment on an appropriate basis and value for the threshold that would determine whether a financial institution should be included in the second or third phase-in category; that is, whether the requirement to submit for clearing a transaction in a mandatory clearable derivative that involves a local counterparty should apply at 6 months or 12 months after the date on which the determination becomes effective. Is average monthly aggregate gross notional outstanding value an appropriate basis for the threshold? If so what time period should be used, for example the last 3 months preceding the determination?

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[2] *Regulation 91-507 respecting Trade Repositories and Derivatives Data Reporting* (Québec); Ontario Securities Commission Rule 91-507 *Trade Repositories and Derivatives Data Reporting*; Manitoba Securities Commission Rule 91-507 *Trade Repositories and Derivatives Data Reporting*; and, once implemented, Proposed Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* (collectively, the **TR Rules**).

Anticipated Costs and Benefits

We believe that the impact of the Clearing Rule, including anticipated compliance costs for market participants, is proportional to the benefits we seek to achieve. Greater transparency in the OTC derivatives market is one of the central pillars of derivatives regulatory reform in Canada and internationally. The G20 has agreed that requiring standardized and sufficiently liquid OTC derivatives transactions to be cleared through central counterparties, where appropriate, will result in more effective management of counterparty credit risk. In addition, central counterparty clearing of derivatives may also contribute to greater stability of our financial markets and to a reduction in systemic risk.

We recognize that counterparties will incur additional costs in order to comply with the Clearing Rule. The primary expenditure associated with the proposed Clearing Rule is the cost of clearing transactions. However, we note that the G20 has also committed to impose capital and collateral requirements on OTC derivative transactions that are not centrally cleared; the related costs may well exceed the costs associated with clearing OTC derivatives transactions. The end-user and intragroup exemptions in the Clearing Rule will help mitigate the initial costs associated with the clearing of OTC derivative transactions. Moreover, the proposed phase-in of the clearing requirement for a mandatory clearable derivative will provide temporary relief for market participants that are not financial entities and smaller or less active financial entities. We note that the phase-in approach of the clearing requirement will allow the local provincial regulators to provide more clarity on the developing derivatives registration regime, and to use trade repository data to investigate whether thresholds or carve-outs are appropriate for certain types of entities.

Local Matters

In Saskatchewan, the following provisions of *The Securities Act, 1988* (the Act) provide the Authority with the authority to adopt the Proposed National Instrument:

- Paragraph 154(1)(h) of the Act authorizes the Authority to make regulations prescribing requirements respecting books, records and other documents that market participants shall keep, including the form in which and the period for which the books, records and other documents shall be kept.
- Paragraph 154(1)(l.1) of the Act authorizes the Authority to make regulations regulating derivatives or varying the application of the Act to derivatives.
- Paragraph 154(1)(ee.11) of the Act authorizes the Authority to make regulations with respect to any matter necessary to regulate self-regulatory organizations, exchanges, derivatives trading facilities, quotation and trade reporting systems, clearing agencies and trade repositories.
- Paragraph 154(1)(oo) of the Act authorizes the Authority to make regulations exempting any person, company, trade or security from all or any provision of the Act or the regulations, including prescribing any terms or limitations on an exemption and requiring compliance with those terms or limitations.

Contents of Annexes

The following annexes form part of this CSA Notice:

- Annex A – Summary of Comments and List of Commenters;
- Annex B – Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives*; and
- Annex C – Proposed Companion Policy 94-101CP *Mandatory Central Counterparty Clearing of Derivatives*.

Comments

Please provide your comments in writing by **May 13, 2015**.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In addition, all comments received will be posted on the websites of each of the Alberta Securities Commission at www.albertasecurities.com, the *Autorité des marchés financiers* at www.lautorite.qc.ca and the Ontario Securities Commission at www.osc.gov.on.ca. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Thank you in advance for your comments.

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Securities Office
Ontario Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Please send your comments **only** to the following addresses. Your comments will be forwarded to the remaining jurisdictions:

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers

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Ontario Securities Commission

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Questions

Please refer your questions to any of:

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