ANNEX C

PROPOSED COMPANION POLICY 94-101CP
MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

GENERAL COMMENTS

Introduction

This Companion Policy sets out how the Canadian Securities Administrators (the "CSA" or "we") interpret or apply the provisions of National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* ("NI 94-101" or the "Instrument") and related securities legislation.

The numbering of Parts and sections in this Companion Policy correspond to the numbering in NI 94-101. Any specific guidance on sections in NI 94-101 appears immediately after the section heading. If there is no guidance for a section, the numbering in this Companion Policy will skip to the next provision that does have guidance.

SPECIFIC COMMENTS

Unless defined in NI 94-101 or explained in this Companion Policy, terms used in NI 94-101 and in this Companion Policy have the meaning given to them in the securities legislation of each jurisdiction including National Instrument 14-101 *Definitions*.

In this Companion Policy, "Product Determination Rule" means,

in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, Multilateral Instrument 91-101 *Derivatives: Product Determination*,

in Manitoba, Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*,

in Ontario, Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*, and

in Québec, Regulation 91-506 respecting Derivatives Determination.

In this Companion Policy, "TR Instrument" means,

in Alberta, British Columbia, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island, Saskatchewan and Yukon, Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting*,

in Manitoba, Manitoba Securities Commission Rule 91-507 *Trade Repositories and Derivatives Data Reporting*,

in Ontario, Ontario Securities Commission Rule 91-507 *Trade Repositories and Derivatives Data Reporting*, and

in Québec, Regulation 91-507 respecting Trade Repositories and Derivatives Data Reporting.

PART 1
DEFINITIONS AND INTERPRETATION

Definitions and interpretation

1. (1)

This Instrument defines "regulated clearing agency". It is intended that only a regulated clearing agency that acts as a central counterparty for over-the-counter derivatives be subject to the Instrument. The purpose of paragraph (c) of this definition is to allow a transaction in a mandatory clearable derivative involving a local counterparty in one of the listed jurisdictions to be submitted to a clearing agency that is not yet recognized or exempted in the local jurisdiction. Paragraph (c) does not supersede any provisions of the securities legislation of the local jurisdiction with respect to any recognition requirements for a person or company that is carrying on the business of a clearing agency in the local jurisdiction.

The Instrument uses the term "transaction" rather than the term "trade" in part to reflect that "trade" is defined in the securities legislation of some jurisdictions as including the termination of a derivative. We do not think the termination of a derivative should trigger a requirement to submit the derivative for central clearing. Similarly, the definition of transaction in NI 94-101 excludes a novation resulting from the submission of a transaction to a regulated clearing agency as this is already a cleared transaction. Finally, the definition of "transaction" is not the same as the definition found in the TR Instrument as the latter does not include a material amendment since the TR Instrument expressly provides that an amendment must be reported.

In the definition of "transaction", the term "material amendment" should be considered in light of the fact that only new transactions will be subject to mandatory central counterparty clearing under NI 94-101. If a derivative that existed prior to the coming into force of NI 94-101 is materially amended after NI 94-101 is effective, that amendment will trigger the mandatory clearing requirement if applicable. A material amendment is one that changes information that would reasonably be expected to have a significant effect on the derivative's attributes, including its value, the terms and conditions of the contract evidencing the derivative, the transaction methods or the risks related to its use, excluding information that is likely to have an effect on the market price or value of its underlying interest. We will consider several factors when determining whether a modification to an existing transaction is a material amendment. Examples of modifications to an existing transaction that would be a material amendment

include any modification which would result in a significant change in the value of the transaction, differing cash flows or the creation of upfront payments.

(2) For the purpose of the interpretation of control, a person or company will always be considered to control a trust to which it is acting as trustee.

PART 2
MANDATORY CENTRAL COUNTERPARTY CLEARING

Duty to submit for clearing

3. (1) The duty to submit a transaction for clearing only applies at the time the transaction is executed. If a derivative or class of derivatives is determined to be a mandatory clearable derivative after the date of execution of a transaction in that derivative or class of derivatives, a local counterparty will not be required to submit the transaction for clearing. However, if after a derivative or class of derivatives is determined to be a mandatory clearable derivative, there is another transaction in that same derivative, including a material amendment to a previous transaction, (as discussed in subsection 1(1) above), that transaction in or material amendment to the derivative will be subject to the mandatory clearing requirement. Where a derivative is not subject to the mandatory clearing requirement, but the derivative is clearable through a regulated clearing agency, the counterparties have the option to submit the derivative for clearing at any time.

For a local counterparty that is not a participant of a regulated clearing agency**,** we have used the phrase "cause to be submitted" to refer to the local counterparty's obligation. In order to comply with subsection (1), a local counterparty would need to have arrangements in place with a participant for clearing services in advance of entering into a transaction in a mandatory clearable derivative.

A transaction in a mandatory clearable derivative is required to be cleared when at least one of the counterparties is a local counterparty and one or more of paragraphs (a), (b) or (c) apply to both counterparties.

A local counterparty that has or has had a month-end gross notional amount of outstanding derivatives exceeding the threshold in paragraph (c), for any month following the entry into force of the Instrument, must clear all its subsequent transactions in a mandatory clearable derivative with another counterparty captured under one or more of paragraphs (a), (b), or (c). A local counterparty that is a participant at a regulated clearing agency who does not subscribe to clearing services for a mandatory clearable derivative would still have to clear such transactions if it is subject to paragraph (c).

A local counterparty determines whether it exceeds the threshold in paragraph (c) by calculating the notional amount of all outstanding derivatives which were entered into by itself and those of its affiliated entities that are also local counterparties. However, the calculation of the gross notional amount excludes derivatives entered into by entities that are prudentially supervised on

a consolidated basis or whose financial statements are prepared on a consolidated basis, which are exempted in section 7.

(2) The Instrument requires that a transaction subject to mandatory central clearing be submitted to a regulated clearing agency as soon as practicable, but no later than the end of the day on which the transaction was executed or if the transaction occurs after business hours of the clearing agency, the next business day.

PART 3
EXEMPTIONS FROM MANDATORY CENTRAL COUNTERPARTY CLEARING

Non-application

6. A transaction involving a counterparty that is an entity listed in section 6 is not subject to the duty to submit for clearing under section 3 even if the other counterparty is otherwise subject to it.

The expression "government of a foreign jurisdiction" in paragraph (a) is interpreted as including sovereign and sub sovereign governments.

Intragroup exemption

7. **(1)** The intragroup exemption is based on the premise that the risk created by these transactions is expected to be managed in a centralized manner to allow for the risk to be identified and managed appropriately.

This subsection sets out the conditions that must be met for the counterparties to rely on the intragroup exemption for a transaction in a mandatory clearable derivative. Subparagraph (a)(i) extends the availability of the intragroup exemption to transactions among certain entities that do not prepare consolidated financial statements. This may apply, e.g., to cooperatives or other entities that are prudentially supervised on a consolidated basis. Entities prudentially supervised on a consolidated basis are counterparties that are supervised on a consolidated basis either by the Office of the Superintendent of Financial Institutions (Canada), a government department or a regulatory authority of Canada or a jurisdiction of Canada responsible for regulating deposit-taking institutions.

Paragraph (c) refers to a system of risk management policies and procedures designed to monitor and manage the risks associated with a particular transaction. We are of the view that counterparties relying on this exemption may structure their centralized risk management according to their unique needs, provided that the program reasonably monitors and manages risks associated with non-centrally cleared derivatives.

(2) Within 30 days of the first transaction between two entities relying on the intragroup exemption, a completed Form 94-101F1 *Intragroup Exemption* ("Form 94-101F1") must be delivered to the regulator to notify the regulator that the exemption

is being relied upon. The information provided in the Form 94-101F1 will aid the regulators in better understanding the legal and operational structure allowing counterparties to benefit from the intragroup exemption. The obligation to deliver the completed Form 94-101F1 is imposed on one of the counterparties to a transaction relying on the exemption. For greater clarity, a completed Form 94-101F1 must be delivered for each pairing of counterparties that seek to rely upon the intragroup exemption. One completed Form 94-101F1 is valid for every transaction between the pair provided that the requirements set out in subsection (1) continue to apply.

(3) Examples of changes to the information provided that would require an amended Form 94-101F1 include: (i) a change in the control structure of one or more of the counterparties listed in Form 94-101F1, and (ii) any significant amendment to the risk evaluation, measurement and control procedures of a counterparty listed in Form 94-101F1.

Multilateral portfolio compression exemption

8. A multilateral portfolio compression exercise is an exercise which involves more than two counterparties who wholly change or terminate the notional amount of some or all of the prior transactions submitted by the counterparties for inclusion in the exercise and, depending on the methodology employed, replace the terminated derivatives with other derivatives whose combined notional amount, or some other measure of risk, is less than the combined notional amount, or some other measure of risk, of the derivatives terminated in the exercise.

The purpose of a multilateral portfolio compression exercise is to reduce operational or counterparty credit risk by reducing the number or notional amounts of outstanding derivatives between counterparties and aggregate gross number or notional amounts of outstanding derivatives.

The expression “resulting transaction” refers to the transaction resulting from the multilateral portfolio compression exercise. The expression “prior transactions” refers to transactions that were entered into before the multilateral portfolio compression exercise. Those prior transactions were not required to be cleared under the Instrument, either because they did not include a mandatory clearable derivative or because they were entered into before the derivative or class of derivatives became a mandatory clearable derivative.

We would expect a local counterparty involved in a multilateral portfolio compression exercise to comply with its credit risk tolerance levels. To do so, we expect each participant to the compression exercise to set its own counterparty, market and cash payment risk tolerance levels so that the exercise does not alter the risk profiles of each participant beyond a level acceptable to the participant. Consequently, prior transactions that would be reasonably likely to significantly increase the risk exposure of the participant cannot be included in the portfolio compression exercise in order to benefit from this exemption.

We would generally expect that the resulting transaction would have the same material terms as the prior transactions with the exception of reducing the notional amount of outstanding derivatives.

Recordkeeping

9. (1) We would generally expect that the reasonable supporting documentation to be kept in accordance with section 9 would include full and complete records of any analysis undertaken by the local counterparty to demonstrate it satisfies the conditions necessary to rely on the intragroup exemption under section 7 or the multilateral portfolio compression exemption under section 8.

The local counterparty subject to the mandatory central counterparty clearing requirement is responsible for determining whether, given the facts available, the exemption is available. Generally, we would expect a local counterparty relying on an exemption to retain all documents that show it properly relied on the exemption. It is not appropriate for a local counterparty to assume an exemption is available.

Counterparties using the intragroup exemption under section 7 should have appropriate legal documentation between them and detailed operational material outlining the risk management techniques used by the overall parent entity and its affiliated entities with respect to the transactions benefiting from the exemption.

PART 4
MANDATORY CLEARABLE DERIVATIVES

and

PART 6
TRANSITION AND EFFECTIVE DATE

10 & 12. A regulated clearing agency must deliver a Form 94-101F2 *Derivatives Clearing Services* ("Form 94-101F2") to identify all derivatives for which it provides clearing services within 30 days of the coming into force of the Instrument pursuant to section 12. A new derivative or class of derivatives added to the offer of clearing services after the Instrument is in force is declared through a Form 94-101F2 within 10 days of the launch of such service pursuant to section 10.

Each of the regulators has the power to determine by rule or otherwise which derivative or classes of derivatives will be subject to the mandatory central counterparty clearing requirement through a top-down approach. Furthermore, NI 94-101 includes a bottom-up approach for determining whether a derivative or class of derivatives will be subject to the mandatory clearing obligation. The information required by Form 94-101F2 will assist the CSA in carrying out this determination.

In the course of determining whether a derivative or class of derivatives will be subject to the clearing requirement, some of the factors we will consider include the following:

- the level of standardization of the derivative, such as the availability of electronic processing, the existence of master agreements, product definitions and short form confirmations;

- the effect of central clearing of the derivative on the mitigation of systemic risk, taking into account the size of the market for the derivative and the available resources of the regulated clearing agency to clear the derivative;

- whether mandating the derivative to be cleared would bring undue risk to regulated clearing agencies;

- the outstanding notional amount of counterparties transacting in the derivative or class of derivatives, the current liquidity in the market for the derivative or class of derivatives and the availability of reliable and timely pricing data;

- the existence of third-party vendors providing pricing services;

- with regards to a regulated clearing agency, the existence of an appropriate rule framework, and the existence of capacity, operational expertise and resources, and credit support infrastructure to clear the derivative on terms that are consistent with the material terms and trading conventions on which the derivative is traded;

- whether a regulated clearing agency would be able to manage the risk of the additional derivatives that might be submitted due to the clearing requirement determination;

- the effect on competition, taking into account appropriate fees and charges applied to clearing, and whether mandating clearing of the derivative could harm competition;

- alternative derivatives or clearing services co-existing in the same market;

- the public interest.

FORM 94-101F1
INTRAGROUP EXEMPTION

Submission of information on intragroup transactions by a local counterparty

In item 3 of section 2, the phrase “in the manner required under the securities legislation” means in accordance with section 28 of the TR Instrument.

The forms delivered by or on behalf of a local counterparty under the Instrument will be kept confidential in accordance with the provisions of the applicable legislation. We are of the view that the forms generally contain proprietary information, and that the cost and potential risks of disclosure for the counterparties to an intragroup transaction outweigh the benefit of the principle requiring that forms be made available for public inspection.

While Form 94-101F1 and any amendments to it will be kept generally confidential, if the regulator considers that it is in the public interest to do so, it may require the public disclosure of a summary of the information contained in such form, or amendments to it.

FORM 94-101F2
DERIVATIVES CLEARING SERVICES

Submission of information on clearing services of derivatives by the regulated clearing agency

Paragraphs (a), (b) and (c) of item 2 in section 2 address the potential for a derivative or class of derivatives to be a mandatory clearable derivative given its level of standardization in terms of market conventions, including legal documentation, processes and procedures, and whether pre- to post- transaction operations are carried out predominantly by electronic means. The standardization of the economic terms is a key input in the determination process as discussed in the following section.

In paragraph (a) of item 2 in section 2, life-cycle events has the same meaning as in section 1 of the TR Instrument.

Paragraphs (d) and (e) of item 2 in section 2 provide details to assist in assessing the market characteristics such as the activity (volume and notional amount) of a particular derivative or class of derivatives, the nature and landscape of the market for that derivative or class of derivatives and the potential impact its determination as a mandatory clearable derivative could have on market participants, including the regulated clearing agency. The determination process will involve different or additional considerations when assessing whether a derivative or class of derivatives should be a mandatory clearable derivative in terms of its liquidity and price availability, versus the considerations used by the regulator in permitting a regulated clearing agency to offer clearing services for a derivative or class of derivatives. Stability in the availability of pricing information will also be an important factor considered in the determination process. Metrics such as the total number of transactions and aggregate notional amounts, and outstanding positions can be used to justify the confidence and frequency with which the pricing of a derivative or class of derivatives is calculated. The data presented should also cover a reasonable period of time of no less than 6 months. Suggested information to be provided on the market includes

- statistics regarding the percentage of activity of participants on their own behalf and for customers,

- average net and gross positions including the direction of positions (long or short), by type of market participant submitting transactions directly or indirectly, and

- average trading activity and concentration of trading activity among participants by type of market participant submitting transactions directly or indirectly.