

**CSA Notice of
National Instrument 94-101
Mandatory Central Counterparty Clearing of Derivatives
and
*Related Companion Policy***

January 19, 2017

Introduction

We, the Canadian Securities Administrators (**CSA** or **we**), are adopting:

- National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the **Instrument**), including:
 - Form 94-101F1 *Intragroup Exemption*
 - Form 94-101F2 *Derivatives Clearing Services*
- Companion Policy 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (the **CP**)

(together, the **National Instrument**).

In some jurisdictions, government ministerial approvals are required for the implementation of the Instrument. Provided all necessary approvals are obtained, the National Instrument will come into force on **April 4, 2017**.

This Instrument is part of the ongoing implementation of Canada's commitments in relation to global OTC derivatives markets reforms stemming from the G20 commitments of 2009 in response to the financial crisis.¹

The CSA Derivatives Committee (the **Committee**) has consulted and collaborated with the Bank of Canada, the Office of the Superintendent of Financial Institutions (Canada), the Department of Finance Canada, and market participants on the determination of certain classes of OTC derivatives as mandatory clearable derivatives. The Committee also continues to contribute to and follow international regulatory developments. In particular, members of the Committee work with international regulators and bodies such as the International Organization of Securities Commissions and the OTC Derivatives Regulators' Group in the development of international standards and regulatory practices.

Although a significant market in Canada, the Canadian OTC derivatives market comprises a relatively small share of the global market, and a substantial portion of

¹ The G20 agreement states that all standardized OTC derivative contracts should be cleared through central counterparties.

derivatives entered into by Canadian market participants involve foreign counterparties. The CSA endeavour to develop rules for the Canadian market that are aligned with international practices to ensure that Canadian market participants have access to the international market and are regulated in accordance with international principles.

We would like to draw your attention to another publication: CSA Notice of National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* which is being published concurrently with this Notice. This publication and the National Instrument both relate to central counterparty clearing.

Substance and Purpose

The purpose of the Instrument is to impose mandatory central counterparty clearing of certain standardized OTC derivatives in order to reduce counterparty risk in the derivatives market and increase financial stability.

The Instrument is divided into two areas: (i) mandatory central counterparty clearing for certain derivatives by certain counterparties (including exemptions), and (ii) the determination of derivatives subject to mandatory central counterparty clearing (each a mandatory clearable derivative).

Background and Summary of Written Comments Received by the CSA

The CSA published Proposed National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* on February 24, 2016 (the **Proposed National Instrument**), inviting public comment on all aspects of the Proposed National Instrument. Six 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 as Annex A to this Notice. Copies of the comment letters can be found on the websites of the Alberta Securities Commission, Ontario Securities Commission and Autorité des marchés financiers.

Summary of Changes to the Proposed National Instrument

We reviewed the comments received and made changes to the Instrument in response. In particular, the Instrument now applies only to an affiliated entity of a clearing participant if the affiliated entity's month-end gross notional amount of outstanding OTC derivatives exceeds \$1 000 000 000 excluding intragroup transactions. A transition period of 90 days following the date on which the affiliated entity first reaches this threshold was also added.

Considering the current scope of application of the Instrument, the availability of the intragroup exemption to entities that are unable to make consolidated financial statements, but that are prudentially supervised, such as cooperatives, is no longer necessary and, therefore, was deleted.

In addition, we received comments on the importance of providing substituted compliance with foreign rules. We have determined that the rules and regulations of the U.S. Commodity Futures Trading Commission and the European Parliament regarding mandatory central counterparty clearing are substantially equivalent, on an outcomes-based approach, to the requirements in the Instrument. As such, counterparties established in a foreign jurisdiction but for whom a local counterparty is responsible for all or substantially all their liabilities may comply with such equivalent foreign rules when submitting their mandatory clearable derivatives to a clearing agency. The other requirements under the Instrument, however, still apply.

Also, a 6-month transition period, as of the effective date, is provided to market participants that are not clearing participants, but are subject to the Instrument, to set up clearing relationships.

Finally, we have simplified the information required in Form 94-101F1. A single form per group, containing each pairing of counterparties availing of the intragroup exemption, must now be sent to the regulator or securities regulatory authority.

We intend to reassess the scope of the Instrument when more market participants reasonably have access to clearing services for OTC derivatives.

Summary of the Instrument

a) Mandatory central counterparty clearing and exemptions

The Instrument provides that a local counterparty to a transaction in a mandatory clearable derivative must submit that derivative for clearing to a regulated clearing agency when both itself and the other counterparty are one or more of the following:

- (i) a participant subscribing to the services of a regulated clearing agency for a mandatory clearable derivative;
- (ii) an affiliated entity of a participant described in (i) if it has an aggregate gross notional amount exceeding \$1 billion in outstanding OTC derivatives, excluding intragroup transactions ;
- (iii) a local counterparty that, together with its local affiliated entities, has an aggregate gross notional amount exceeding \$500 billion in outstanding OTC derivatives, excluding intragroup transactions.

A non-application section lists counterparties which are not subject to the Instrument. Two exemptions are also provided in the Instrument for some transactions. Subject to certain conditions, the Instrument exempts mandatory clearable derivatives between affiliated entities that have consolidated financial statements. A counterparty relying on this intragroup exemption must deliver a Form 94-101F1 to the regulator or securities

regulatory authority identifying the other counterparty and the basis for relying on the exemption.

Subject to certain conditions, the Instrument also exempts mandatory clearable derivatives that result from a multilateral portfolio compression exercise.

A counterparty relying on either exemption must keep records to demonstrate its eligibility for the exemption.

b) Determination of mandatory clearable derivatives

We have determined certain classes of interest rate derivatives (**IRD**) denominated in U.S. dollars (**USD**), euros (**EUR**), British pounds (**GBP**) and Canadian dollars (**CAD**) as mandatory clearable derivatives (collectively, the **Determination**). In making the Determination, we have considered factors including:

- information on OTC derivatives cleared by regulated clearing agencies,
- markets of importance to Canadian financial stability, and
- foreign central clearing mandates.

Regulated clearing agencies have notified the Committee of all the OTC derivatives or classes of OTC derivatives for which they provide clearing services. For each of these derivatives or classes of derivatives, the Committee has assessed whether it is suitable for mandatory central clearing by examining the criteria set out in the CP.

We have also considered publicly available data, derivatives data reported pursuant to local derivatives data reporting rules² and foreign regulators' proposals, including their analysis of the standardization and risk profile of the mandatory clearable derivatives and the liquidity and characteristics of their market.

International harmonization is also an important factor considered by the Committee when making a determination on whether a type or class of derivatives should be a mandatory clearable derivative. In the absence of broadly harmonized requirements, there may be potential for regulatory arbitrage or other distortions in market participants' choices as to where to conduct business or book trades.

The following list of mandatory clearable derivatives for all jurisdictions of Canada is included in the Instrument as Appendix A.

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 Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting* .

Interest Rate Swaps

Type	Floating index	Settlement currency	Maturity	Settlement Currency Type	Optionality	Notional type
Fixed-to-float	CDOR	CAD	28 days to 30 years	Single currency	No	Constant or variable
Fixed-to-float	LIBOR	USD	28 days to 50 years	Single currency	No	Constant or variable
Fixed-to-float	EURIBOR	EUR	28 days to 50 years	Single currency	No	Constant or variable
Fixed-to-float	LIBOR	GBP	28 days to 50 years	Single currency	No	Constant or variable
Basis	LIBOR	USD	28 days to 50 years	Single currency	No	Constant or variable
Basis	EURIBOR	EUR	28 days to 50 years	Single currency	No	Constant or variable
Basis	LIBOR	GBP	28 days to 50 years	Single currency	No	Constant or variable
Overnight index swap	CORRA	CAD	7 days to 2 years	Single currency	No	Constant or variable
Overnight index swap	FedFunds	USD	7 days to 3 years	Single currency	No	Constant or variable
Overnight index swap	EONIA	EUR	7 days to 3 years	Single currency	No	Constant or variable
Overnight index swap	SONIA	GBP	7 days to 3 years	Single currency	No	Constant or variable

Forward Rate Agreements

Type	Floating index	Settlement currency	Maturity	Settlement Currency Type	Optionality	Notional type
Forward rate agreement	LIBOR	USD	3 days to 3 years	Single currency	No	Constant or variable
Forward rate agreement	EURIBOR	EUR	3 days to 3 years	Single currency	No	Constant or variable
Forward rate agreement	LIBOR	GBP	3 days to 3 years	Single currency	No	Constant or variable

In particular, IRD represent more than 80% of the aggregate gross notional amount in outstanding OTC derivatives reported in Ontario and Québec. Among the types of IRD traded, single currency interest rate swaps (**IRS**) are most relevant. IRD are also highly standardized, thus posing minimal operational concerns for clearing unlike more complex and exotic products. There is also sufficient liquidity for clearing in IRD. IRD are not only traded by local participants, but also by local branches and affiliates of foreign participants. Furthermore, the majority of local counterparties that are subject to the Instrument have already begun clearing IRS on regulated clearing agencies.

The Determination is harmonized across Canada and, to the greatest extent possible, with international practices. Certain classes of IRD denominated in USD, GBP, EUR and CAD are already mandated to be cleared in the United States, in Australia, and in Europe.

Although the European Parliament has not determined CAD IRS as mandatory clearable derivatives under its regulation, local counterparties complying with European laws under the substituted compliance provision of the Instrument must clear CAD IRS.

Anticipated Costs and Benefits of the Instrument

We believe that the impact of the Instrument, including anticipated compliance costs for market participants, is proportional to the benefits we seek to achieve. The G20 has agreed that requiring standardized and sufficiently liquid OTC derivatives to be cleared through central counterparties will result in more effective management of counterparty credit risk through multilateral netting of derivatives positions and mutualisation of losses through a default fund. As such, central counterparty clearing of the derivatives included in the Determination contributes to greater stability of our financial markets and reduced systemic risk.

We recognize that counterparties may incur additional costs in order to comply with the Instrument due to the increase in derivatives that are centrally cleared. However, we note that the G20 has also committed to imposing margin requirements on OTC derivatives

that are not centrally cleared; the related costs may well exceed the costs associated with clearing OTC derivatives. The intragroup and multilateral portfolio compression exemptions in the Instrument will help mitigate the costs borne by counterparties as a result of the Instrument.

Moreover, the narrow scope of application of the Instrument will provide relief for certain categories of market participants. We will continue to monitor trade repository data to assess the characteristics of the markets for OTC derivatives mandated to be cleared to inform whether the \$500 billion threshold for a local counterparty and its local affiliated entities to be subject to mandatory clearing should be lowered and, if so, whether carve-outs might be appropriate for certain types of entities.

Local Matters

The scope of derivatives subject to the Instrument in each local jurisdiction is set out in the applicable local product determination rule, i.e., Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*, Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*, Regulation 91-506 respecting Derivatives Determination (**Regulation 91-506**) and Multilateral Instrument 91-101 *Derivatives: Product Determination* (collectively, the **Product Determination Rules**).

Concurrently with the publication of this Notice, the Autorité des marchés financiers is publishing consequential amendments in respect of the National Instrument to Regulation 91-506.

Contents of Annexes

The following annexes form part of this CSA Notice:

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

Questions

Please refer your questions to any of the following:

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