CSA STAFF CONSULTATION PAPER 91-301

MODEL PROVINCIAL RULES – *DERIVATIVES: PRODUCT DETERMINATION*
AND
TRADE REPOSITORIES AND DERIVATIVES DATA REPORTING

1. Introduction

We, the Canadian Securities Administrators OTC Derivatives Committee (the "Committee") are publishing for a 60 day-comment period:

- Model Provincial Rule – *Derivatives: Product Determination* (the "Scope Rule"),
- Model Explanatory Guidance to Model Provincial Rule – *Derivatives: Product Determination* (the "Scope EG"),
- Model Provincial Rule – *Trade Repositories and Derivatives Data Reporting* (the "TR Rule"), and
- Model Explanatory Guidance to Model Provincial Rule – *Trade Repositories and Derivatives Data Reporting* (the "TR EG").

Collectively the Scope Rule, the Scope EG, the TR Rule and the TR EG will be referred to as the "Model Rules".

We are issuing this notice to provide interim guidance and solicit comments on the Model Rules, which currently have been drafted based on existing provisions of Ontario securities law. Once we have considered comments received on the Model Rules and made appropriate changes, each jurisdiction will publish its own rules, explanatory guidances and appendices, with necessary local modifications.[1]

2. Background

In order to implement the G-20 commitments[2] that relate to the regulation of the trading of derivatives in Canada, the Committee has been working on recommendations both independently and in collaboration with the Canadian OTC Derivatives Working Group.[3] Since November 2010, the Committee has published a series of derivatives consultation papers outlining policy recommendations for the regulation of derivatives in Canada.[4] In formulating these recommendations, the Committee has sought to strike a balance between proposing regulation that does not unduly burden participants in the derivatives market, while at the same time addressing the need to introduce effective regulatory oversight of derivatives and derivatives market activities.

The regulatory framework will be implemented through provincial rules that are intended to impose specific regulatory requirements tailored to address the unique characteristics of derivatives products, how they are marketed and traded, the sophistication of the counterparties, existing regulation in other areas (such as the regulation of financial institution), and the risks they present to the derivatives and financial markets. To the greatest extent appropriate, the derivatives rules will be harmonized with international standards and be consistent across Canada.

3. Rule-making process

The next stage in the Committee's rule-making process is the publication for comment of a number of "model" rules covering a variety of areas of regulation that together will create a regime for the regulation of derivatives markets. The "model" rules will reflect the public commentary on the consultation papers and are the Committee's recommendations for specific proposals to regulate the derivatives market in Canada. Due to variations in provincial securities legislation, the final provincial rules will contain differences. However, it is the intention of the Committee that the substance of the rules will be the same across jurisdictions, and market participants and derivative products will receive the same treatment across Canada.

The Model Rules have been drafted based on the *Securities Act* (Ontario) and should be considered in the context of that legislation. Subsequent model rules will be based on other provincial statutes and in each case the accompanying notice will identify the legislation upon which the rules are based.

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1 In some cases, jurisdictions with substantively similar securities legislation may consider developing and publishing multi-lateral instruments.

2 The G-20 commitments include requirements that all standardized over-the-counter derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. Moreover, over-the-counter derivative contracts should be reported to trade repositories. Also, non-centrally cleared contracts should be subject to higher capital requirements.

3 The Canadian OTC Derivatives Working Group consists of the Bank of Canada, the federal Department of Finance, the Office of the Superintendent of Financial Institutions, the Alberta Securities Commission, the Autorité des marchés financiers, the British Columbia Securities Commission and the Ontario Securities Commission.

4 91-401 *Over-the-Counter Derivatives Regulation in Canada*, 91-402 *Derivatives: Trade Repositories*, 91-403 *Derivatives: Surveillance and Enforcement*, 91-404 *Segregation and Portability in OTC Derivatives Clearing*, 91-405 *Derivatives: End User Exemption*, and 91-406 *Derivatives: OTC Central Counterparty Clearing.*

Each of the "model" rules (including the Model Rules being published with this notice) will be published for a consultation period of 60 days after which the Committee will evaluate comments received and recommend appropriate amendments to the proposed rule. Once this process is completed, each province will publish province-specific rules for comment in accordance with the legislative requirements of the province. In a number of provinces legislative amendments will need to be implemented before province-specific rules can be published for consultation. Because of this, publication dates of province-specific rules may vary. Once each province's comment period has been completed, final rules will be implemented by that province.

4. Substance and purpose of the Scope Rule

The Scope Rule provides a foundation for the regulation of derivatives that is both responsive and flexible. The broad definition of "derivative" in existing and proposed provincial securities legislation is intended to include the types of instruments traditionally referred to as derivatives (for example, swaps and forwards) as well as other novel instruments.[5] Legislation in many Canadian jurisdictions contemplates that an instrument that meets the general definition of derivative may be treated as a derivative, a security, or be excluded in whole or in part from regulation.

The definitions of "derivative" and "security" in securities legislation are, or will be, expansive and, in some cases, overlapping. The Scope Rule is intended to resolve conflicts that arise when a contract or instrument meets both the definition of "derivative" and "security". By making clear which contracts or instruments are to be regulated as derivatives, securities or are outside the scope of securities or derivatives legislation, the Scope Rule provides the flexibility to appropriately tailor regulation to a broad range of existing and emerging products.

The Scope Rule will initially only apply for the purposes of the TR Rule. The Committee expects that the Scope Rule, subject to necessary amendments, will also be made applicable to existing provisions of securities legislation, and to future derivatives rules that will be brought into force, including but not limited to rules relating to over-the-counter central counterparty clearing, end-user exemptions, trading platforms, capital and collateral, and registration. However, there may be variations in the Scope Rule for these new rules. In particular, certain contracts or instruments that are prescribed to be securities or derivatives for the purposes of the TR Rule may be treated differently in other new rules.

Until the Scope Rule has been extended to other derivatives rule-making areas any legislation, rules, notice or other policies applicable to derivatives will continue to apply. For example, OSC Staff Notice 91-702 – *Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors in Ontario* would continue to apply to these types of instruments until any new rules replacing the treatment as described in the notice have been implemented.

5. Substance and purpose of the TR Rule

The TR Rule describes proposed requirements for the operation and ongoing regulation of designated or recognized trade repositories and the reporting of derivative transaction data by market participants. The purpose of the TR Rule is to improve transparency in the derivatives market to regulators and the public, and ensure that designated trade repositories operate in a manner that promotes the public interest. Trade repository data is essential for regulatory oversight of the derivatives market. This oversight will allow regulators to address a variety of risks including monitoring of systemic risk and the risk of market abuse. Derivatives data reported to designated trade repositories will also assist policy-making by providing regulators with information on the nature and characteristics of the Canadian derivatives market.

The TR Rule can generally be divided into two rule-making areas (i) those relating to the regulation of trade repositories (including rules with respect to the designation/recognition process, requirements and restrictions relating to data dissemination and ongoing operational requirements), and (ii) those relating to reporting requirements of derivatives market participants. As explained above, the Scope Rule outlines the contracts or instruments that are required to be reported to designated or recognized trade repositories.

Please note that the TR EG does not provide guidance on Appendix A. Guidance for Appendix A is included in the interpretive column of the reporting fields in the appendix.

6. Foreign-based trade repositories and market participants

In order for any trade repository, local or foreign, to be an acceptable venue for local market participants to comply with the reporting obligations contained in Part 3 of the TR Rule, the trade repository must be designated or recognized in the applicable provincial jurisdiction. However, the Committee recommends that exemptions under section 40 of the TR Rule to certain requirements of the TR Rule be made available to a foreign-based trade repositories if the trade repository is subject to an equivalent regulatory and oversight regime in its home jurisdiction. We recognize that some foreign-based trade repositories are already subject to equivalent regulation in their home jurisdiction and believe that the imposition of a duplicate regime is inefficient.

The Committee has attempted to harmonize reporting requirements under the TR Rule with international practice. It is the Committee's view that the reporting of derivative transaction data by market participants that are located in a foreign-jurisdiction

[5] Some jurisdictions are developing amendments to securities legislation to adopt a definition of "derivative". The provisions of the Scope Rule are dependent on the approval in each jurisdiction of definitions of "derivative" that are substantively similar to those jurisdictions that have already adopted a definition.

but whose derivatives activities trigger reporting requirements under the TR Rule is appropriate and is not an unnecessary burden. To the extent that minor differences exist between a foreign regime's reporting requirements and those in the TR Rule, it would be possible to apply for an exemption on the grounds of equivalency.

7. Local aspects of the model rules

In this section of the notice, we have included information specific to the securities legislation of certain CSA jurisdictions that relates to the Model Rules.

- **Alberta, British Columbia, New Brunswick, Nova Scotia and Saskatchewan**

These provinces are in the process of considering amendments to their securities acts. In these provinces the implementation of final rules based on the Model Rules will be dependent on the legislative amendments developed in each jurisdiction. Specific information relating to the application of final rules based on these Model Rules will be provided when province-specific rules are published for comment.

- **Manitoba**

The Model Rules apply only to derivatives that are traded over-the-counter, because commodity futures contracts and commodity futures options as defined in subsection 1(1) of the *Commodity Futures Act* (Manitoba) are excluded from the definition of "derivative" in the *Securities Act* (Manitoba).

- **Ontario**

The Model Rules apply only to derivatives that are traded over-the-counter, because commodity futures contracts and commodity futures options as defined in subsection 1(1) of the *Commodity Futures Act* (Ontario) are excluded from the definition of "derivative" in the *Securities Act* (Ontario). It is proposed that the Model Rules will be made by the Ontario Securities Commission under the rule-making authority set out in the *Securities Act* (Ontario). For greater certainty, the Model Rules will not be made under, or governed by, the provisions of the *Commodity Futures Act* (Ontario).

- **Quebec**

In Quebec, the *Derivatives Act* (Québec) governs both over-the-counter and exchange-traded derivatives. The treatment of certain contracts or instruments prescribed by the Scope Rule has already been implemented under that legislation. As such, the Autorité des marchés financiers ("AMF") does not intend to propose the adoption of certain sections of the Scope Rule because these sections are already covered by or excluded from the *Derivatives Act* (Québec).

The following is a list of Scope Rule provisions that will not be adopted and the corresponding *Derivatives Act* (Québec) or the *Securities Act* (Québec) provisions:

Scope Rule	***Derivatives Act* ("QDA") or *Securities Act* ("QSA")**
2(b)	This section is already covered by paragraph 6(3) of the QDA.
2(e)(f)	Deposits are securities under the QSA - see paragraph 1(3) and would most certainly be predominantly a security according to section 4 of the QDA.
3	This section is already covered by paragraph 6(2) of the QDA.
4	This section is already addressed by the hybrid test under section 4 of the QDA.
5	This section is already covered by paragraph 6(4) of the QDA.

The AMF will rely on its rulemaking powers to designate as a derivative or exclude from the application of the QDA an instrument or contract, respectively at paragraphs 176(1) and 175(7) of the QDA, to adopt the remaining sections.

8. Comments

We request your comments on the Model Rules and Appendix A. The Committee also seeks specific feedback on subsection 40(2) of the TR Rule that provides an exemption for reporting requirements for derivatives transactions in the physical commodity market involving market participants with small derivatives exposures. The text of the proposed exemption is as follows:

Despite anything in this Rule, there is no obligation under this Rule for a local counterparty to report derivatives data in relation to a physical commodity transaction if the local counterparty is not a dealer or adviser and has less than $500 000 aggregate notional value, without netting, under all its outstanding transactions, at the time of the transaction including the additional notional value related to that transaction.

The purpose of this exemption is to reduce regulatory burdens for small market participants whose physical commodity transactions may include contractual terms that would make them subject to transaction reporting requirements. The Committee seeks guidance as to whether this exemption and the proposed $500 000 threshold are appropriate.

You may provide written comments in hard copy or electronic form. The comment period expires February 4, 2013.

The Committee will publish all responses received on the websites of the Autorité des marchés financiers (www.lautorite.qc.ca) and the Ontario Securities Commission (www.osc.gov.on.ca).

Please address your comments to each of the following:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission

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

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Questions

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