CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Notice of Publication
Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives
and Related Policy Statement

January 19, 2017

Introduction

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

- *Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives* (the **Regulation**), including:
  - Form 94-101F1 *Intragroup Exemption*
  - Form 94-101F2 *Derivatives Clearing Services*

- *Policy Statement to Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives* (the **Policy Statement**)

(together, **Regulation 94-101**).

In some jurisdictions, government ministerial approvals are required for the implementation of the Regulation. Provided all necessary approvals are obtained, Regulation 94-101 will come into force on **April 4, 2017**.

This Regulation 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 derivatives entered into by Canadian market participants involve foreign counterparties.

[1] The G20 agreement states that all standardized OTC derivative contracts should be cleared through central 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 *Regulation 94-102 respecting Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* which is being published concurrently with this Notice. This publication and Regulation 94-101 both relate to central counterparty clearing.

Substance and Purpose

The purpose of the Regulation 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 Regulation 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 Draft *Regulation 94-101 respecting Mandatory Central Counterparty Clearing of Derivatives* on February 24, 2016 (the **Draft Regulation 94-101**), inviting public comment on all aspects of the Draft Regulation 94-101. 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 Draft Regulation 94-101

We reviewed the comments received and made changes to the Regulation in response. In particular, the Regulation 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 Regulation, 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 Regulation. 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 Regulation, 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 Regulation, 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 Regulation when more market participants reasonably have access to clearing services for OTC derivatives.

Summary of the Regulation

a) Mandatory central counterparty clearing and exemptions

The Regulation 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 Regulation. Two exemptions are also provided in the Regulation for some transactions. Subject to certain conditions, the Regulation 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, except in

Québec, or securities regulatory authority identifying the other counterparty and the basis for relying on the exemption.

Subject to certain conditions, the Regulation 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 Policy Statement.

We have also considered publicly available data, derivatives data reported pursuant to local derivatives data reporting rules[2] 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 Regulation 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 Regulation 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 Regulation must clear CAD IRS.

Anticipated Costs and Benefits of the Regulation

We believe that the impact of the Regulation, 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 Regulation 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 Regulation will help mitigate the costs borne by counterparties as a result of the Regulation.

Moreover, the narrow scope of application of the Regulation 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 Regulation 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 Regulation 94-101 to Regulation 91-506.

Contents of Annex

The Summary of Comments and List of Commenters are published in Annex A of this Notice.

Questions

Please refer your questions to any of the following:

Lise Estelle Brault
Co-Chair, CSA Derivatives Committee
Senior Director, Derivatives Oversight
Autorité des marchés financiers
514-395-0337, ext. 4481
lise-estelle.brault@lautorite.qc.ca

Kevin Fine
Co-Chair, CSA Derivatives Committee
Director, Derivatives Branch
Ontario Securities Commission
416-593-8109
kfine@osc.gov.on.ca

Paula White
Deputy Director, Compliance and Oversight
Manitoba Securities Commission
204-945-5195
paula.white@gov.mb.ca

Martin McGregor
Legal Counsel, Corporate Finance
Alberta Securities Commission
403-355-2804
martin.mcgregor@asc.ca

Michael Brady
Manager, Derivatives
British Columbia Securities Commission
604-899-6561
mbrady@bcsc.bc.ca

Abel Lazarus
Senior Securities Analyst
Nova Scotia Securities Commission
902-424-6859
abel.lazarus@novascotia.ca

Wendy Morgan
Senior Legal Counsel
Financial and Consumer Services Commission
(New Brunswick)
506-643-7202
wendy.morgan@fcnb.ca

Liz Kutarna
Deputy Director, Capital Markets, Securities
Division
Financial and Consumer Affairs Authority of
Saskatchewan
306-787-5871
liz.kutarna@gov.sk.ca

ANNEX A
COMMENT SUMMARY AND CSA RESPONSES

Section Reference	Issue/Comment	Response
General comment: Personal property security legislation	A commenter argued that provincial personal property security laws in the common law provinces should be amended to allow the perfection of security interests in cash collateral by way of control.	No change. We note that federal bankruptcy and provincial personal property security legislation are outside of the jurisdiction of the provincial securities regulatory authorities. The Committee is seeking to implement requirements which protect customer collateral, to the extent possible, under existing Canadian federal and provincial legal frameworks.
Subsection 3(1) – General comments	Several commenters expressed strong support for the narrowing of the scope of Regulation 94-101 to only the largest participants in the OTC market. One commenter recommended that the CSA continue to monitor the data and, once participants have easier access to clearing, a lower threshold may be possible.	No change. The scope of application addresses concerns of market participants regarding access to clearing. The Committee intends to reassess this scope when more market participants reasonably have access to clearing services for OTC derivatives.
Subsection 3(1) – Counterparties subject to mandatory central counterparty clearing	Two commenters expressed concern with respect to the identification of counterparties under paragraphs 3(1)(b) and (c). The commenters requested the addition of a requirement for local counterparties entering into mandatory clearable derivatives to notify their counterparties if they satisfy the requirements under paragraph 3(1)(a), (b) or (c). They further suggested that the Committee expressly provide that counterparties can rely on self-declaration, or lack of a self-declaration if one is not received by the trade date, in determining	Change made. Guidance has been added in the Policy Statement to explain that we are flexible as to how market participants declare their status to each other. We provided guidance that a counterparty in scope must solicit confirmation from its counterparty where there is a reasonable basis to believe that the counterparty may be near or above any of the thresholds in paragraph 3(1)(b) or (c).

	whether subsection 3(1) of Regulation 94-101 applies to a mandatory clearable derivative. Since the pricing of a trade will vary depending on whether it will be cleared, Regulation 94-101 should also expressly provide that such reliance on self-declaration, or lack thereof, remains in effect for the entire term of the trade. Any change in status should only apply to trades entered into after the change in status is disclosed to the relevant counterparty.	
	Two commenters recommended that the scope of counterparties included under paragraph 3(1)(b) be narrowed considering that Regulation 94-101 would result in additional operational burden and cost for smaller affiliates of clearing participants, some of whom may be end-users. They recommended excluding an affiliate of a clearing participant with *de minimis* trading activity.	Change made. The Regulation now applies only to affiliated entities of clearing participants if the affiliated entity's month-end gross notional amount under all outstanding OTC derivatives is above $ 1 000 000 000. The Regulation now also provides a 90-day transition period for an affiliated entity of a clearing participant after the date on which it first exceeds this threshold in order to prepare for clearing.
	A commenter asked for the Committee to confirm that the Regulation would not apply to a local counterparty that has foreign affiliated entities that are participants of clearing agencies or clearing houses that are not regulated in Canada. Specifically, the commenter sought confirmation that the clearing requirement would not apply unless both (i) the clearing agency of which the foreign affiliated entity is a clearing participant is a "regulated clearing agency"; and (ii) the products that the foreign affiliate	No change. An entity affiliated with a clearing participant of a regulated clearing agency is subject to mandatory central counterparty clearing if it is entering into a mandatory clearable derivative. The Committee intends to respect the Product Determination Rules in making product determinations.

	clears are "specified derivatives" (as defined in MI 91-101).	
Subsection 3(5) – Substituted compliance for some local counterparties	One commenter fully supported the substituted compliance provisions under subsection 3(5) of Regulation 94-101, which would allow a foreign affiliate to clear a mandatory clearable derivative pursuant to comparable foreign rules. As well, this commenter fully supported that, at a minimum, the U.S. *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Dodd-Frank") and *Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories* ("EMIR") be listed in Appendix B to Regulation 94-101 as foreign rules which are comparable to Regulation 94-101.	Change made. Appendix B includes laws and regulations from the U.S. Commodity Futures Trading Commission (the "CFTC") and European Securities and Markets Authority ("ESMA") regarding mandatory central counterparty clearing.
Section 7 – Intragroup exemption	A commenter expressed concern regarding what agreement is required between affiliated entities to satisfy the conditions of the intragroup exemption. The commenter requested clarification in the Policy Statement that a master agreement between the counterparties would satisfy the exemption. The commenter does not believe it is industry standard or practice to require transaction confirmations (and in some cases even a master agreement) between affiliated entities. As well, the commenter recommended amending the Form 94-101F1 to remove the transaction level requirement or	Change made. Section 7 provides flexibility to accommodate different types of transaction agreements. The Policy Statement provides that an International Swaps and Derivatives Association ("ISDA") master agreement would be acceptable if it is dated and signed by the affiliated entities and comprises the material terms of the trading relationship between the affiliated entities for the mandatory clearable derivative. We have reduced the information required under Form 94-101F1, focusing on the relationship between the counterparties rather than on their transaction. All pairings of affiliated entities

	add further clarification that the form only needs to be delivered once per pair of counterparties for it to cover all transactions between the pair.	relying on the intragroup exemption may be included in one single form sent to the regulator or securities regulatory authority.
	One commenter sought clarification as to which one of the affiliated entities should agree to rely on the exemption.	No change. The agreement must be provided by a person authorized to agree on behalf of each counterparty.
	Two commenters felt that submitting the form directly to the regulator, rather than to a trade repository (which is the case under Dodd-Frank), is overly burdensome as this would require submission to multiple provincial regulators. They recommended that Form 94-101F1 be submitted to an approved trade repository.	No change. One Form 94-101F1 can be completed per group and sent to all appropriate regulators or securities regulatory authorities.
Section 9 – Recordkeeping	A commenter requested clarification in the record keeping section of the Policy Statement regarding the use of the terms 'analysis' and 'appropriate legal documentation' in respect of records relating to the intragroup exemption.	No change. The Policy Statement provides that counterparties must keep records demonstrating that they meet the necessary criteria to rely on the intragroup exemption. Counterparties have flexibility as to what documentation would be required to show that they meet such criteria.
Former section 13 – Effective date	A commenter supported a simultaneous effective date for both Regulation 94-101 and the determination of mandatory clearable derivatives since they are already required to be cleared by mandates of other jurisdictions. Another commenter suggested that the requirement to clear could come into effect simultaneously only for clearing participants described in paragraph 3(1)(a) of Regulation 94-101. For the other two	Change made. A transition period of 6 months after the Regulation is in force was included for market participants that are not clearing participants in order to set up clearing relationships.

	categories of counterparties described in paragraphs 3(1)(b) and (c), the commenter recommended a transition period of 12 months from the time the Regulation becomes effective.	
Appendix A – Mandatory clearable derivatives: General Comments	Several commenters agree that the Determination is consistent with international standards and appropriate for Canadian markets.	No change. The mandatory clearable derivatives are also subject to clearing mandates in some foreign jurisdictions.
	Two commenters agreed that the characteristics used in Appendix A are considered adequate to define mandatory clearable derivatives.	No change. We appreciate the commenters' submissions.
	A commenter expressed that the CSA's approach to rule-making or amendments to Regulation 94-101 would not be sufficiently agile to respond to market events that require swift regulatory actions, as consensus with multiple regulatory authorities (both provincial and federal) could be required to suspend or terminate a mandatory clearing mandate.	No change. Members of the CSA have the power to suspend or terminate mandatory central counterparty clearing through decisions such as blanket orders or discretionary relief.
	A commenter requested that the CSA make clear that NGX's clearing model would not cause market participants using the NGX clearing platform to be "participants" under the Regulation in the event NGX did offer clearing services for a derivative that could be subjected to mandatory clearing.	No change. All product determination analysis will take into consideration the CCPs offering clearing services in those products and the operational structures of such CCPs.
Appendix A – Mandatory clearable derivatives	A commenter noted that the stated maturity for Overnight Index Swaps ("OIS") in USD, EUR and GBP of 7 days to 30 years is inconsistent with the CFTC clearing requirements for OIS in USD, EUR and GBP, and	Change made. The stated maturity has been aligned with the clearing mandates under foreign regulations. Accordingly, the maturity of OIS was changed to 7 days to 3 years for EUR, USD and GBP.

	recommended that the CSA change the maturity for these currencies to 7 days to 2 years.	
	A commenter noted that if an interest rate swaption or extendible swap is entered into prior to the effective date of the Draft Regulation 94-101, even if the swaption is physically settled by entering into an IRS after this effective date or the extendible swap is extended after this effective date, mandatory clearing should not apply to the interest rate swap or extended swap as the cost of clearing the underlying swap may not have been reflected in the price of the swaption or extendible swap. On the other hand, if a cash-settled swaption is entered into before the effective date of Regulation 94-101, but is amended after the effective date to switch to physical settlement, mandatory clearing could apply to the interest rate swap entered into upon settlement of the swaption as this is a material change to the terms of the contract.	Change made. Clarifications are provided in the Policy Statement consistent with the approach taken by the U.S. CFTC such that mandatory central counterparty clearing only applies to swaps resulting from the exercise of a swaption entered into after the Regulation is in force unless the swaption is amended after the effective date. The same rationale would apply to the extension of an extendible swap entered into before the Regulation was in force.

	One commenter requested guidance with respect to swaps (listed in Appendix A to the Regulation) that a clearing agency cannot accept for clearing due to non-standard terms. One commenter asked for guidance regarding complex swaps (such as bespoke products, for example, an extendible swap which has an embedded optionality) and packaged transactions, similar to the approach taken under Dodd-Frank.	Change made. The Policy Statement has been changed to clarify that market participants need not disentangle a complex transaction in order to clear a component of that transaction which is a mandatory clearable derivative. For packaged transactions, if they contain a component that is a mandatory clearable derivative, that component should be cleared even if the balance of the packaged transaction is not cleared.
	Several commenters recommended, where a CAD IRS is entered into and one of the counterparties is not a local counterparty, delaying mandatory central counterparty clearing for such product until it becomes a subject to mandatory clearing under either EMIR or Dodd-Frank. One commenter stated that, without international harmonization requiring the clearing of CAD IRS, Canadian banks and counterparties would be negatively impacted if foreign counterparties withdraw from the market, thereby reducing the ability of Canadian banks and counterparties to hedge their risks. Another commenter recognized the importance of CAD IRS to the financial stability of the Canadian market.	No change. The CFTC has announced that CAD IRS is a mandatory clearable derivative under Dodd-Frank, effective 60 days following the date on which the Regulation enters into force. Regulation 94-101 is harmonized on this point, thus limiting any potential for regulatory arbitrage.

List of Commenters

1. Canadian Advocacy Council
2. Canadian Commercial Energy Working Group
3. Canadian Market Infrastructure Committee
4. Canadian Bankers Association
5. International Energy Credit Association
6. LCH.Clearnet Group Limited