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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 from time to time. In Québec, the determination process will be made by decision and the

[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

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.

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:

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Autorité des marchés financiers
800, square Victoria, 22e étage
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Questions

Please refer your questions to any of:

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ANNEX A

COMMENT SUMMARY AND CSA RESPONSES

Section Reference	Issue/Comment	Response
General Comments	Harmonization A number of commenters raised concerns about a possible lack of harmonization across provinces in the implementation of the Clearing Rule and in the determination of derivatives to be subject to mandatory clearing.	Change made. We note that the Committee has now opted to develop a national instrument, given its intention that the substance of the rules be the same across jurisdictions, and that market participants and derivative products will receive the same treatment across Canada, both in terms of participants (similar exemptions) and of products (same determinations) included. See *Determination of mandatory clearable derivatives* above.
	Implementation A commenter requested greater clarity regarding the intended timing of implementation and application of the Clearing Rule. Another commenter recommended that the local provincial regulators give sufficient time to counterparties to get set up with their clearing intermediaries and agents.	No change. The committee would like to see the rule in place by Q4 2015 or Q1 2016. We note that a requirement to clear would not be triggered until a proposed determination has been published for comment and a final determination made. See *Phase-in of the requirement to clear a mandatory clearable derivative* above.
	Determination Four commenters were concerned about the harmonization, within Canada and at the international level, of derivatives subject to mandatory clearing. Three commenters proposed a joint determination process for the local provincial regulators. Three commenters suggested types or classes of derivatives that should or should not be mandated for clearing, and one	No change. See *Determination of mandatory clearable derivatives* above. We also note that the existence of master agreements or short form confirmations is a factor considered in evaluating the level of standardization of a derivative.

	commenter discussed additional factors to consider when making a determination. Two commenters suggested that a "top-down approach" whereby local provincial regulators assess what types of products and transactions contribute to systemic risk in the market and determine, based on their analysis, that certain products are "clearable derivatives", should be considered in addition to the bottom-up approach. Another commenter supported an approach whereby a regulator cannot mandate that a clearing agency clears a particular clearable derivative. Finally, five commenters requested that regulators provide advance notice or mandatory consultations with the industry before mandating a derivative or class of derivatives for clearing.	
	<u>Scope</u> A commenter submitted that OTC derivative transactions involving physical commodities such as OTC natural gas commodity hedging transactions should not be classified as derivatives per the Draft Model Rule's definitions and therefore should not be subject to the pending derivatives legislation.	No change. We note that it is the intention of the Committee that the determinations to be made will not include derivatives that are outside the scope of the local *Derivatives: Product Determination*[3] rules.
S. 1 – Definitions: Local Counterparty	A commenter pointed out that the local counterparty definition in TR Rules differs from the local counterparty definition in the Draft Model Rule.	No change. We note that the inclusion of registrants in the local counterparty definition of the Clearing Rule would result in requiring foreign registrants to

[3] Manitoba Securities Commission Rule 91-506 *Derivatives: Product Determination*, Ontario Securities Commission Rule 91-506 *Derivatives: Product Determination*, Québec *Regulation 91-506 Respecting Derivatives Determination* and Proposed Multilateral Instrument 91-101 *Derivatives: Product Determination* (the **Scope Rules**).

		clear even when there is no local counterparties involved in a transaction.
	A number of commenters requested additional guidance on concepts such as "head office", "principal place of business" and "affiliate" or, more specifically, what is meant by "responsible for the liabilities of that affiliated party". Another commenter suggested cross-referencing the definition of local counterparty found in the Policy Statement of the TR Rules.	No change. We note that these are longstanding legal concepts.
	A commenter pointed out that the definition of local counterparty brings into the clearing requirements numerous counterparties that conduct no business and, in particular, do not carry out any derivative trading activities in Canada, such as companies organized under a province law but which have no actual presence or business in Canada.	No change. We note that a local provincial regulator may exempt entities or groups of entities in its jurisdiction.
S. 1 – Definitions: Financial Entity	A commenter pointed out that former paragraph 1(g) reference to former paragraph 1(f) would capture any entity anywhere in the world that might potentially be subject to registration as a derivatives dealer in Canada. The practical effect of this is that any such party transacting with a local counterparty that is itself a financial entity may be subject to mandatory clearing requirements in Canada regardless of whether the transaction is eligible for a clearing exemption in such party's own jurisdiction. Another commenter suggested that a local counterparty has	No change. See *Determination of mandatory clearable derivatives* above. We note that the local provincial regulators intend to adopt a "stricter rule applies" principle in case of cross-border discrepancies. As a result, when a foreign party transacts with a local counterparty in a derivative that is subject to mandatory clearing under the Clearing Rule, the transaction must be cleared even if an exemption exists in the foreign party's jurisdiction. We also note that the Committee continues to monitor the development of cross-border guidance with respect to

	satisfied its clearing requirement in respect of a transaction if the counterparty to that transaction is not a local counterparty and, if under the applicable laws of the foreign jurisdiction, such transaction is exempt from clearing because the counterparty qualifies for an exemption.	substituted compliance on clearing requirements.
	A number of commenters have requested more clarity on the upcoming registration regime, or to wait until the regime is in place before mandating derivatives to be cleared. Moreover, a number of commenters expressed concern with the inclusion of certain entities in the definition of financial entity, such as pension funds, investment funds (mortgage investment entities, private equity funds and venture capital funds) and entities registered or exempt from registration.	No change. See *Phase-in of the requirement to clear a mandatory clearable derivative* above. We note that the phase-in approach to 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.
	A commenter suggested that, in former paragraph (g), reference should also be made to entities that would be regulated "or exempted from regulation" under the applicable legislation of Canada or the applicable local jurisdiction to conform to former paragraph (f). The commenter further suggested that the statement "had it been organized in Canada or the applicable local jurisdiction" is not necessary.	Change made. See revised section 1. We note that entities exempted from registration are included in the financial entity definition. See *Phase-in of the requirement to clear a mandatory clearable derivative* above.
S. 1 – Definitions: Transaction	Three commenters proposed that trades which reduce risk, such as compression replacement trades, terminations, compression amended trades (partial unwinds) and certain risk rebalancing	No change. We note that the Committee will continue to monitor international regulatory developments with regards to trade compression.

	trades resulting from post-trade risk reduction services should not trigger the clearing requirement.	
	A commenter pointed out that it would be beneficial to have an objective test to determine what is considered to be a "large change".	No change. We note that the Committee considers that the proposed approach provides flexibility as an entity should be able to establish subjectively whether a transaction was amended with the sole purpose of avoiding the central clearing requirement.
Former S. 3 – Interpretation of hedge or mitigation of commercial risk	A number of commenters have requested additional guidance on the concepts of "hedging" and "mitigating commercial risk", and how these differ from "speculation". Commenters also suggested that the Committee adopt a flexible approach to these concepts given the wide variety of derivatives, potential end-users, and hedging strategies to which the Clearing Rule will apply. Another commenter encouraged the recognition of derivatives, which satisfy the requirements under IFRS or U.S. GAAP to be accounted for as hedges, as being held for the purpose of hedging or mitigating commercial risk.	No change. We note that the Committee considers that the proposed approach provides flexibility and legal certainty, and that the Clearing CP provides sufficient guidance on the concepts of "hedging" and "mitigating commercial risk". Additional guidance may be published once compliance with the Clearing Rule is assessed. We also note that hedges meeting the stricter accounting standards should be sufficient to meet the conditions of the end-user exemption.
	A number of commenters requested additional or revised guidance with regards to the interpretation of commercial risk or a definition for the terms "closely correlated" and "highly effective".	Changes made. See revised section 4 on Interpretation of hedge or mitigation of commercial risk.
	A number of commenters pointed out that the list of risks in former paragraphs 3(a)(i) and (ii) may not be exhaustive.	Changes made. We note that the amendments brought to paragraphs 4(1)(a) and (b) are consistent with the definition of Derivatives in the *Securities Act* (Ontario).

	A commenter suggested that the addition of "incurring in the normal course of its business" at the end of former paragraph 3(a)(i) may be problematic as companies develop new risk management strategies as they enter into new lines of business and new commercial arrangements.	No change. We note that new activities occur in the normal course of business. Entities can therefore use the end-user exemption as long as the conditions are met.
	Two commenters stated that they enter into commodity derivatives trading with their customers as part of their core business and are required to hedge these transactions. However, given that the transactions with their customers are not held for the purpose of hedging or mitigating commercial risk, they cannot benefit from the end-user exemption (see former paragraph 3(b)(ii)). They argued that former paragraph 3(b)(ii) should be modified so that the ineligibility applies only where the party concerned is hedging in its capacity as an intermediary or market-maker in derivatives, rather than hedging to mitigate a commercial risk of another kind.	No change. We note that the end-user exemption specifically targets transactions that are entered into to hedge or mitigate a commercial risk incurred by an eligible entity.
Former subsection 4(1) – Duty to submit for clearing	Two commenters pointed out that there may not be sufficient time to clear a transaction before the end of the day if that transaction is executed shortly before the clearing agency closes.	No change. We note that this issue should not materialize where straight-through processing is implemented. The Committee will monitor the implementation of the rule and may provide further guidance if needed.
	A commenter pointed out that technically, the "transaction" is not submitted for clearing. If the transaction has the required features, then the clearer submits the deal terms and a new transaction with the clearing	No change. We note that the Committee believes that the Clearing Rule provides sufficient clarity as currently drafted.

	agency is created. The contract between the original parties no longer exists.	
Former subsection 4(2) – Duty to submit for clearing: substituted compliance	Two commenters suggested to broaden the concept of substituted compliance such that the clearing requirement would be satisfied if the transaction was submitted for clearing, pursuant to the laws of another Canadian jurisdiction or the laws of an approved foreign jurisdiction, to a clearing agency recognized in that jurisdiction.	Partial change made. Substituted compliance was added for a local counterparty in a reliant jurisdiction if the transaction is submitted for clearing to a regulated clearing agency of another jurisdiction of Canada. See *Determination of mandatory clearable derivatives* above. We note that the Committee continues to monitor the development of cross-border guidance with respect to substituted compliance on clearing requirements.
Former S. 5 – Notification	Three commenters were concerned with the operational consequences of considering a transaction to be void *ab initio* if it is rejected for clearing by the clearing agency.	Changes made. See revised Section 7 of the Policy Statement. The guidance now refers to the rules of the clearing agencies and to the legal arrangements governing indirect clearing in place with regards to the rejection of transactions.
Former S. 7 – End-user exemption	A number of commenters pointed out that the end-user exemption should not require a formal agency relationship.	Change made. The reference to "agent" has been removed from former paragraph 7(2)(a).
	A number of commenters requested precisions on the end-user exemption: • Are both the end-user exemption and the intragroup exemption available for intragroup transactions? • Can an entity self-exempt on the basis that it is not a financial entity and is undertaking transactions to hedge or mitigate risk? • In the event that both counterparties are not financial entities, is it	No change. We note that: • Both the end-user exemption and the intragroup exemption are available for intragroup transactions unless the entity seeking exemption is a financial entity (cannot use the end-user exemption). • It is the responsibility of the entity seeking to be exempted to determine whether the exemption applies to its transactions.

	sufficient that only one party satisfies the requirement under former paragraph 7(1)(b)?	• In the event that both counterparties are not financial entities, it is sufficient that only one party satisfies the requirement under paragraph 9(1)(b).
	A number of commenters have requested that the end-user exemption be available to small financial entities (including credit unions, captive financial companies, registered dealers and registered portfolio managers) that fall below a threshold coherent with the size of the Canadian OTC derivatives market. Moreover, a commenter suggested allowing registered dealers to exercise the end-user exemption when hedging the risk of their affiliates, as long as such affiliates would qualify to exercise the end-user exemption on their own.	No change. See *Phase-in of the requirement to clear a mandatory clearable derivative* above. 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, such as credit unions.
	A commenter stated that former paragraph 7(2)(c) should refer to an affiliated entity that is not subject to a registration requirement, or that is exempted from a registration requirement, under the securities legislation of a jurisdiction of Canada. Failing to include all exempt entities on a general basis may prevent access to the exemption even where there the policy rationale underlying the Draft Model Rule does not support it.	Change made. See revised paragraph 9(2)(c).
	A commenter proposed to add "at least" prior to "one of the counterparties is not a financial entity" to make it clear that the end-user exemption is also	Changes made. See revised paragraph 9(2)(a).

	available to two parties if neither of them is a financial entity.	
Former S. 8 – Intragroup exemption	Two commenters questioned the necessity of Form F1 in the context of securities regulation. A commenter suggested that the intragroup exemption be simplified such that transactions between 100% owned affiliates are exempt as long as certain conditions are met without the need for additional agreements or forms. Three commenters proposed that a Form F1 should be effective until withdrawn, unless updates or notifications of change to the originally filed form are submitted. Two other commenters requested that parties should be permitted to provide a listing of all types of transactions in a particular sub-asset class expected between them.	Change made. We note that the Committee believes that Form F1 is necessary in all cases, even for 100% owned affiliates. We note, however, that the annual filing requirement has been removed and replaced with a requirement to amend the original filing with a notification of material change.
	A commenter asked whether "prudentially supervised" is intended to refer to federally-regulated financial entities that are under the regulatory jurisdiction of the Office of the Superintendent of Financial Institutions.	No change. We note that "entities prudentially supervised on a consolidated basis" refers to two 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.
	Two commenters suggested that the requirement that the entities prepare statements on a consolidated basis is not necessary and may unduly exclude affiliated entities that should otherwise properly be	No change. We note that the former paragraph 8(1)(b) is sufficiently broad to allow entities which do not prepare financial statements on a consolidated basis to rely on the Intragroup exemption.

	able to rely on the exemption. They suggested the adoption of the securities laws' "affiliate" definition.	
	A commenter suggested that transactions between credit unions and their centrals should benefit from the intragroup exemption.	No change. We note that the proposed phase-in of the clearing requirement provides temporary relief for credit unions and their centrals. The proposed phase-in of the clearing requirement will also allow the local provincial regulators to use trade repository data to investigate whether thresholds or carve-outs are appropriate for certain types of entities.
	A commenter pointed out that the documentation related to the intragroup exemption should be flexible and should refer to the CFTC and EMIR rules on the matter.	No change. We note that the Committee has reviewed the CFTC and EMIR rules on the matter and believes the Clearing Rule provides sufficient flexibility.
	A commenter suggested that it should be clarified that reference to "securities legislation of a jurisdiction of Canada" includes commodity futures and derivatives legislation.	No change. We note that "securities legislation" is defined in NI 14-101 and includes in Québec the *Derivatives Act*. In other jurisdictions, the relevant *Securities Act* applies. We further note that it is the intention of the Committee to respect the Scope Rules in the determinations to be made.
	A commenter would like confirmation that the intragroup exemption is available to registered dealers as long as they satisfy the necessary criteria.	No change. We note that the intragroup exemption applies to registered dealers as long as the criteria provided by the exemption are met.
	A commenter proposed that former paragraph 8(2)(c) could be shortened to simply stipulate the requirement for a written agreement setting out the terms of the transaction between the counterparties.	Changes made. See revised paragraph 10(2)(c).

Former S. 9 – Improper use of exemption	Three commenters requested clarification on how the local provincial regulators would determine that an entity has improperly used an exemption, and on the process by which the local provincial regulators would direct a local counterparty to submit a transaction for clearing under section 4.	Changes made. Former section 9 on Improper use of exemption has been removed as local regulators have the legal powers to enforce regulations.
Former S. 9 – Record keeping	A commenter pointed out that a party to an OTC derivatives transaction should be able to rely on representations made by the other party, without any further investigation or documentation, in order to determine whether the clearing requirement applies.	Changes made. See additional guidance included in Section 11 of the Clearing CP. We note, however, that certain conditions must be met for a local counterparty to rely on factual representations by the other counterparty.
	A commenter pointed out that, with respect to the requirement in former subsection 9(1) and specifically with respect to the Intragroup exemption, it should be sufficient that the records are kept by one of the "intragroup" parties.	No change. We note that it is not expected that documents or legal opinions be kept by each counterparty; however, both counterparties must be able to make copies of these agreements available to the regulator upon request.
	Three commenters questioned the necessity to obtain board approval for qualifying for the end-user exemption. A commenter suggested that a board of directors should be required to authorize the use of the end-user exemption no more than annually and requested that the CSA permit lower-tier entities to rely upon authorization from the board of directors of a higher-tier affiliate to exercise the exemption.	Changes made. See revised paragraph 11(1). End-users will not be required to obtain board approval in order to qualify for the end-user exemption.
	A number of commenters requested additional guidance and questioned the level of detail required as supporting	No change. We note that hedge-accounting compliant record-keeping is not a requirement for all hedging derivatives under the

	documentation with respect to each transaction for which the end-user exemption will be relied upon. They also expressed the opinion that it imposed a heavy regulatory burden on participants using this exemption. Notably, a number of commenters requested guidance on how the Committee requires entities to assess or document their hedging effectiveness.	Clearing Rule. However, hedges meeting the stricter accounting standards should be sufficient to meet the conditions of the end-user exemption.
Former S. 10– Non-Application	Two commenters requested that the non-application be extended to foreign governments, entities owned by foreign governments and recognized supra-national agencies, such as the International Monetary Fund.	Change made. See amendments made to section 6 on Non-Application. We note that non-application has not been extended to recognized supra-national agencies. The Committee expects to receive exemption requests from these entities.
	A commenter requested that the non-application should be extended to entities wholly owned by a federal, or provincial government, **or** to entities whose obligations are guaranteed by a federal or provincial government. Another commenter proposed that the non-application should be extended when a crown corporation or other corporation owned by the government is an agent of the Crown without a guarantee being in place. Another commenter argued that government-related entities that are also agents of the Crown should be granted the same immunity through former section 10 as government.	No change. We note that in the case of entities wholly owned by the government of Canada, a government of a jurisdiction of Canada or a government of a foreign jurisdiction, the non-application is only extended to those entities whose obligations are guaranteed, respectively, by the government of Canada, a government of a jurisdiction of Canada or a government of a foreign jurisdiction.
	A number of commenters were opposed to the non-application of the Draft Model Rule to federal and provincial governments and to government entities. A	No change. We note that the local provincial regulators retain the right to modify the applicability of all exemptions and may register certain entities given the

	commenter suggested limiting the application of former section 10 only to those government entities whose OTC derivatives portfolios are not in excess of a certain threshold.	size of their activities.
Former S. 12 – Transition	Two commenters suggested that parties should not have to clear transactions entered into before the coming into force of this rule if they are "materially amended" as this requirement may deter parties from making amendments for legitimate purposes. Two commenters requested confirmation that the end-user and intragroup exemptions will apply to Material Changes.	No change. See the interpretation of material amendment in the Clearing CP. We note that the end-user and intragroup exemptions will apply to material amendments.
	A commenter suggested that an objective test would be beneficial to determine whether an amendment is material.	No change. We note that the Committee considers that the proposed approach provides flexibility as an entity should be able to establish whether a transaction was amended materially. Guidance on material amendments is provided in the Clearing CP.
Form F1	A commenter requested that the word "application" be removed from section 3 of the form. A commenter asked whether this information will be accessible to the public.	Changes made. We note that Form F1 is a notice filing and not an application.
Form F2	A commenter requested that the access given to regulators be limited to "applicable" books and records.	Changes made. See revised Form F2.

List of Commenters

1. Atlantic Central
2. Bruce Power L.P.
3. Caisse de dépôt et placement du Québec
4. Canadian Bankers Association
5. Canadian Commercial Energy Working Group submitted by Sutherland Asbill & Brennan LLP
6. CanadianLife and Health Insurance Association Inc.
7. Capital Power
8. Central 1
9. Canadian Market Infrastructure Committee
10. Concentra Financial
11. Enbridge Inc.
12. Encana Corporation
13. Énergie NB Power
14. Financial Institutions Commission
15. Ford Motor Company
16. FortisBC Energy Inc.
17. Global Foreign Exchange Division
18. IGM Financial Inc.
19. International Swaps and Derivatives Association
20. Investment Industry Association of Canada
21. Just Energy Group Inc.
22. KfW Bankengruppe
23. LCH.ClearnetGroup Limited
24. New Brunswick Investment Management Corporation
25. Pension Investment Association of Canada
26. Sask Energy Incorporated
27. Sask Power
28. Shell Trading
29. Stewart McKelvey
30. Suncor Energy Inc.
31. TMX Group Limited
32. Trans Canada Corporation
33. Tri Optima AB
34. Western Union Business Solutions

ANNEX B

PROPOSED NATIONAL INSTRUMENT 94-101
MANDATORY CENTRAL COUNTERPARTY CLEARING OF DERIVATIVES

PART 1
DEFINITIONS AND INTERPRETATION

Definitions

1. In this Instrument,

"financial entity" means any of the following:

(a) an association governed by the *Cooperative Credit Associations Act* (Canada) or a central cooperative credit society for which an order has been made under subsection 473(1) of that Act;

(b) a bank, loan corporation, loan company, trust company, trust corporation, insurance company, treasury branch, credit union, caisse populaire, financial services cooperative, or league that, in each case, is authorized by an enactment of Canada or a jurisdiction of Canada to carry on business in Canada or a jurisdiction of Canada;

(c) a pension fund that is regulated by either the Office of the Superintendent of Financial Institutions (Canada) or a pension commission or similar regulatory authority of a jurisdiction of Canada;

(d) an investment fund;

(e) a person or company, other than an individual, that under the securities legislation of a jurisdiction of Canada is any of the following:

(i) subject to the registration requirement;

(ii) registered;

(iii) exempted from the registration requirement;

(f) a person or company organized under the laws of a foreign jurisdiction that is similar to an entity referred to in any of paragraphs (a) to (e);

"local counterparty" means a counterparty to a transaction if, at the time of execution of the transaction, either of the following applies:

(a) the counterparty is a person or company to which one or more of the following apply:

(i) it is organized under the laws of the local jurisdiction;

(ii) its head office is in the local jurisdiction;

(iii) its principal place of business is in the local jurisdiction;

(b) the counterparty is an affiliated entity of a person or company referred to in paragraph (a) and the person or company is responsible for the liabilities of the counterparty;

"mandatory clearable derivative" means,

(a) except in Québec, a derivative or a class of derivatives listed in Appendix A, and

(b) in Québec, a derivative or a class of derivatives that is determined by the Autorité des marchés financiers to be subject to the clearing requirement;

"transaction" means either of the following:

(a) entering into, materially amending, assigning, acquiring or disposing of a derivative;

(b) the novation of a derivative, other than a novation resulting from submitting the derivative to a regulated clearing agency;

"regulated clearing agency" means,

(a) except in Québec, a person or company recognized or exempted from recognition as a clearing agency in the local jurisdiction, and

(b) in Québec, a person recognized or exempted from recognition as a clearing house.

Application – Québec

2. In Québec, this Instrument applies to derivatives that are not traded on an exchange and to derivatives that are traded on a derivatives trading facility.

Interpretation of the term affiliated entity

3. (1) In this Instrument, a company will be deemed to be an affiliated entity of another company if one of them is the subsidiary of the other or if both are

subsidiaries of the same company or if each of them is controlled by the same person or company.

(2) In this section, a company will be deemed to be controlled by another person or company or by two or more companies if

(a) voting securities of the first-mentioned company carrying more than 50 per cent of the votes for the election of directors are held, otherwise than by way of security only, by or for the benefit of the other person or company or by or for the benefit of the other companies, and

(b) the votes carried by such securities are entitled, if exercised, to elect a majority of the board of directors of the first-mentioned company.

(3) In this section, a company will be deemed to be a subsidiary of another company if one of the following applies:

(a) it is controlled by,

(i) that other,

(ii) that other and one or more companies each of which is controlled by that other, or

(iii) two or more companies each of which is controlled by that other;

(b) it is a subsidiary of a company that is that other's subsidiary.

Interpretation of hedging or mitigating commercial risk

4. (1) In this Instrument, a counterparty's transaction is considered to be for the purpose of hedging or mitigating commercial risk if, at the time of the transaction, the transaction establishes a position which is intended to reduce risk relating to the commercial activity or treasury financing activity of the counterparty or of an affiliated entity of the counterparty and either of the following apply:

(a) that derivative covers risk arising from the change in the value, price, rate or level of assets, services, inputs, products, commodities or liabilities that the counterparty or an affiliated entity of the counterparty owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;

(b) that derivative covers the risk arising from the indirect impact on the value, price, rate or level of assets, services, inputs, products, commodities or liabilities referred to in paragraph (a), resulting from fluctuation of one or more interest rates, inflation rates, foreign exchange rates or credit risk;

(2) Despite subsection (1), a counterparty's transaction is not considered to be for the purpose of hedging or mitigating commercial risk if the position referred to in subsection (1) is held for either of the following purposes:

(a) to speculate;

(b) to offset or reduce the risk of another transaction, unless such position is itself held for the purpose of hedging or mitigating commercial risk.

PART 2
MANDATORY CENTRAL COUNTERPARTY CLEARING

Duty to submit for clearing

5. (1) A local counterparty to a transaction in a mandatory clearable derivative must submit, or cause to be submitted, that transaction for clearing to a regulated clearing agency that provides clearing services for that mandatory clearable derivative.

(2) A local counterparty submitting a transaction for clearing under subsection (1) must submit the transaction in accordance with the rules of the regulated clearing agency, as amended from time to time.

(3) A local counterparty must submit a transaction for clearing under subsection (1) not later than

(a) if the transaction is executed during the business hours of the regulated clearing agency, the end of the day of execution, or

(b) if the transaction is executed after the business hours of the regulated clearing agency, the end of the next business day.

(4) In Newfoundland and Labrador, the Northwest Territories, Nunavut, Prince Edward Island and Yukon, a local counterparty satisfies subsection (1) if the transaction in a mandatory clearable derivative is submitted for clearing, or caused to be submitted, to a clearing agency or clearing house that is recognized or exempted from recognition pursuant to the securities legislation of another jurisdiction of Canada.

(5) A local counterparty that is a local counterparty solely under paragraph (b) of the definition of local counterparty satisfies subsection (1) with respect to a transaction if the transaction is submitted for clearing in accordance with the laws of a foreign jurisdiction that

(a) except in Québec, is listed in Appendix B, and

(b) in Québec, appears on a list determined by the Autorité des marchés financiers.

Non-application

6. Section 5 does not apply to a transaction if any of the counterparties is one of the following:

(a) the government of Canada, the government of a jurisdiction of Canada or the government of a foreign jurisdiction;

(b) a crown corporation whose obligations are guaranteed by the government of the jurisdiction in which the crown corporation was constituted;

(c) an entity wholly owned by a government referred to in paragraph (a) whose obligations are guaranteed by that government;

(d) the Bank of Canada or a central bank of a foreign jurisdiction;

(e) the Bank for International Settlements.

Notice of rejection

7. If a regulated clearing agency rejects a transaction submitted to it for clearing, the regulated clearing agency must immediately notify each local counterparty to the transaction.

Public disclosure of clearable and mandatory clearable derivatives

8. A regulated clearing agency must publicly disclose on its website, and must allow access to that website at no cost to the public, a list of all derivatives or classes of derivatives for which it will provide clearing services and, for each derivative or class of derivatives listed, identify whether it is a mandatory clearable derivative.

PART 3
EXEMPTIONS AND APPLICATION

End-user exemption

9. (1) Section 5 does not apply to a transaction if both of the following apply:

(a) at least one of the counterparties to the transaction is not a financial entity;

(b) a counterparty that is not a financial entity is entering into the transaction for the purpose of hedging or mitigating commercial risk.

(2) Section 5 does not apply to a transaction entered into by an affiliated entity of a counterparty that is not a financial entity if all of the following apply:

(a) the affiliated entity is acting on behalf of the counterparty that is not a financial entity;

(b) the transaction is entered into for the purpose of hedging or mitigating commercial risk;

(c) the affiliated entity is not subject to, registered under or exempted from the registration requirement under the securities legislation of a jurisdiction of Canada.

Intragroup exemption

10. (1) In this section, "intragroup transaction" means a transaction between either of the following:

(a) two counterparties that are prudentially supervised on a consolidated basis;

(b) a counterparty and its affiliated entity if the financial statements for the counterparty and its affiliated entity are prepared on a consolidated basis in accordance with accounting principles as defined by the National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*.

(2) Section 5 does not apply to an intragroup transaction if all of the following conditions apply:

(a) both counterparties agree to rely on this exemption;

(b) the transaction is subject to centralized risk evaluation, measurement and control procedures reasonably designed to identify and manage risks;

(c) there is a written agreement setting out the terms of the transaction between the counterparties.

(3) No later than the 30th day after a local counterparty to an intragroup transaction relies on the exemption in subsection (2), the local counterparty must submit to the regulator, in an electronic format, a completed Form 94-101F1 *Intragroup Exemption*.

(4) No later than the 10th day after a local counterparty becomes aware that the information in a previously submitted Form 94-101F1 *Intragroup Exemption* is no longer accurate, the local counterparty must submit to the regulator, in an electronic format, an amended Form 94-101F1 *Intragroup Exemption*.

Record keeping

11. (1) A local counterparty to a transaction that relies on section 9 or section 10 must maintain, for a period of 7 years following the date on which the transaction expires or terminates, records demonstrating that the conditions referred to in those sections, as applicable, were satisfied.

(2) The records required to be maintained under subsection (1) must be

(a) kept in a safe location and in a durable form, and

(b) provided to the regulator within a reasonable time following request.

PART 4
MANDATORY CLEARABLE DERIVATIVES

Submission of information on clearing services for derivatives by a regulated clearing agency

12. No later than the 10th day after a regulated clearing agency first provides or offers clearing services for a derivative or class of derivatives, the regulated clearing agency must submit to the regulator, in an electronic format, a completed Form 94-101F2 *Derivatives Clearing Services*, identifying the derivative or class of derivatives.

PART 5
EXEMPTION

Exemption

13. (1) The regulator or the securities regulatory authority may grant an exemption to this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

(2) Despite subsection (1), in Ontario, only the regulator may grant an exemption.

(3) Except in Alberta and Ontario, an exemption referred to in subsection (1) is granted under the statute referred to in Appendix B of National Instrument 14-101 *Definitions* opposite the name of the local jurisdiction.

PART 6
TRANSITION AND EFFECTIVE DATE

Transition – regulated clearing agency filing requirement

14. No later than the 30th day after the coming into force of this Instrument, a regulated clearing agency must submit to the regulator, in an electronic format, a completed Form 94-101F2 *Derivatives Clearing Services*, identifying all derivatives or classes of derivatives for which it provided clearing services as of the date of the coming into force of this Instrument.

Effective date

15. This Instrument comes into force on [*insert date*].

APPENDIX A

MANDATORY CLEARABLE DERIVATIVES

[Derivative or] Class of derivatives	**Date on which section 5 applies to a transaction involving a local counterparty**
[*description of derivative*]	[*Insert date* •] - for a local counterparty that is a member of a regulated clearing agency that offers clearing services for the derivative or class of derivatives and subscribes to such service, [*Insert the date which is 6 months after* •] - for a local counterparty that is a financial entity which [*insert specific threshold*] [*Insert the date which is 12 months after* •] - for a local counterparty that is a financial entity, other than a financial entity which [*insert specific threshold*], [*Insert the date which is 18 months after* •] - for a local counterparty that is not one of the following: a member of a regulated clearing agency that offers clearing services for the derivative or class of derivatives and subscribes to such service, or a financial entity.

APPENDIX B

EQUIVALENT CLEARING LAWS OF FOREIGN JURISDICTIONS PURSUANT TO PARAGRAPH 5(5)(a)

The laws and regulations of each of the following jurisdictions outside of Canada are considered equivalent for the purposes of paragraph 5(5)(a).

Jurisdiction	Law, Regulation and/or Instrument

FORM 94-101F1
INTRAGROUP EXEMPTION

Type of Filing: ☐ **INITIAL** ☐ **AMENDMENT**

Section 1 – Notifying counterparty information

1. State the full legal name of the notifying counterparty that relied on the exemption for an intragroup transaction.

2. Disclose the name under which it conducts business, if different from item 1:

3. If this Form is used to report a name change on behalf of the counterparty referred to in item 1 or item 2, enter the previous name and the new name:

   Previous name:
   New name:
   Head office:
   Address:
   Mailing address (if different):
   Telephone:
   Website:

   Contact employee:
   Name and title:
   Telephone:
   E-mail:

   Other offices:
   Address:
   Telephone:
   Email:

   Canadian counsel (if applicable)
   Firm name:
   Contact name:
   Telephone:
   E-mail:

Section 2 – Combined notification on behalf of other counterparties within the group to which the notifying counterparty belongs

1. Provide a statement confirming that both counterparties to each transaction to which this report relates chose to rely on the intragroup exemption and describe the basis on which the exemption is available to them.

2. Provide a statement confirming that each transaction to which this report relates is subject to appropriate centralized risk evaluation, measurement and control procedures. Describe those procedures.

3. State the legal entity identifier of both counterparties to each transaction to which this report relates in the manner required under the securities legislation.

4. For each transaction to which this report relates, describe the ownership and control structure of the counterparties that are affiliated entities.

5. For each transaction to which this report relates, state whether there is a written agreement setting out the terms of the transaction and, if so, state the date of the agreement and the signatories to the agreement and describe the agreement.

Section 3 – Certification

I certify that I am authorised to submit this Form on behalf of the notifying counterparty and, where applicable, on behalf of the other affiliated entities listed above in Section 2 and that the information in this Form is true and correct.

DATED at _____ this _____ day of _____, 20____

_____
(Print name of authorized person)

_____
(Print title of authorized person)

_____
(Signature of authorized person)

_____ _____
(Email) (Phone number)

Instructions: Submit this form to the regulator in the local jurisdiction as follows:

[*Insert names of each jurisdiction and email or other address by which submission is to be made.]*

FORM 94-101F2
DERIVATIVES CLEARING SERVICES

Type of Filing: ☐ **INITIAL** ☐ **AMENDMENT**

Section 1 – Regulated Clearing Agency Information

1. Full name of regulated clearing agency:

2. Contact information of person authorized to submit this form:

   Name and title:
   Telephone:
   E-mail:

Section 2 – Description of Derivatives

1. Identify each derivative or class of derivatives for which the regulated clearing agency provides clearing services, for which a Form 94-101F2 has not previously been filed.

2. For each derivative or class of derivatives referred to in item 1, describe all material attributes of the derivative including:

   (a) standard practices for managing any life cycle events, as defined in the securities legislation, associated with the derivative,

   (b) the extent to which it is electronically confirmable,

   (c) the degree of standardization of the contractual terms and operational processes,

   (d) the market for the derivative or class of derivatives, including its participants, and

   (e) data on the volume and liquidity of the derivative or class of derivatives within Canada and internationally.

3. Describe the impact of providing clearing services for the derivative or class of derivatives on the regulated clearing agency's risk management framework and financial resources, including the default waterfall and the effect on the clearing members.

4. Describe the extent to which the regulated clearing agency can maintain compliance with its regulatory obligations should the regulator or securities regulatory authority mandate the clearing of the derivative or class of derivatives.

5. Describe the clearing services to be provided.

6. If applicable, attach a copy of the notice the regulated clearing agency provided to its members and a summary of any concerns received in response to that notice.

Section 3 – Certification

CERTIFICATE OF REGULATED CLEARING AGENCY

I certify that I am authorized to submit this form on behalf of the regulated clearing agency named below and that the information in this form is true and correct.

DATED at _____ this _____ day of _____, 20____

_____
(Print name of regulated clearing agency)

_____
(Print name of authorized person)

_____
(Print title of authorized person)

_____
(Signature of authorized person)

Instructions: Submit this form to the regulator in the local jurisdiction as follows:

[*Insert names of each jurisdiction and email or other address by which submission is to be made.]*

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* and in Manitoba, Ontario and Québec, local rule or regulation 91-506 on Derivatives: Product Determination.

In this Companion Policy, "TR Instrument" means,

> in Manitoba and Ontario, local Rule 91-507 *Trade Repositories and Derivatives Data Reporting*
>
> in Québec, Regulation 91-507 respecting Trade Repositories and Derivatives Data Reporting, and
>
> in Alberta, British Columbia, New Brunswick, Nova Scotia and Saskatchewan, Proposed Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting*.[4]

[4] This Instrument has been published for consultation, but has not yet come into force.

PART 1
DEFINITIONS AND INTERPRETATION

Definitions

1. The term "financial entity" is defined in NI 94-101 for the purposes of the end-user exemption in section 9 of the Instrument, which provides that a transaction will only be exempt from mandatory clearing if the hedging counterparty is not a financial entity.

The entities referred to under subparagraph (b) of the definition of "financial entity" do not include a company or its affiliates that lend to customers to finance the purchase of its non-financial goods or services.

The investment funds included in subparagraph (d) are those described in subsections 1.2 (1), (2) and (3) of National Instrument 81-106 *Investment Fund Continuous Disclosure* regarding the application of that instrument to investment funds.

Subparagraph (f) of the definition of "financial entity" addresses the situation where a foreign counterparty enters into a transaction in a mandatory clearable derivative with a local counterparty. If the foreign counterparty is similar to an entity referred to in any of paragraphs (a) to (e) of the definition of "financial entity", the end-user exemption will not be available for that transaction unless the local counterparty qualifies to benefit from the end-user exemption.

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.

The term "material amendment" in the definition of "transaction" 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. 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. The term "derivative" is defined in section 3 of the Québec *Derivatives Act* to include both "standardized" and "over-the-counter" derivatives. Standardized derivatives are derivatives traded on a published market, as provided by section 3 of the Québec *Derivatives Act*. A published market is defined to include an exchange, an alternative trading system or any other derivatives market that constitutes or maintains a system for bringing together buyers and sellers of standardized derivatives. As such, section 2 of the Instrument limits the application of the Instrument to derivatives that are not traded on an exchange; however, an exception is made for derivatives trading facilities.

Interpretation of hedging or mitigating commercial risk

4. The interpretation in the Instrument of the phrase "for the purpose of hedging or mitigating commercial risk" focuses on the purpose and effect of one or more transactions. A market participant executing a transaction for the purpose of hedging would not be precluded from relying on the end-user exemption if a perfect hedge is not ultimately achieved. The use of multiple transactions as a hedging strategy would not in itself preclude an end-user from relying on the exemption. There will be situations where an end-user may be able to rely on the exemption even where some of the transactions could be interpreted as not being a hedge, as long as there is a reasonable commercial basis to conclude that such transactions were intended to be part of the end-user's hedging strategy.

The concept of hedging or mitigating commercial risk excludes all activities that are investing or speculative in nature. However, in some cases macro, proxy or portfolio hedging may benefit from the exemption. The strategy or program should be documented and, where reasonable, subject to regular compliance audits to ensure it continues to be used for relevant hedging purposes. Hedging a risk can be a dynamic process and it is expected that an entity may have to close-out or add contracts to the original hedging position should it begin to under- or over-perform. These additional transactions may also benefit from the exemption provided the transactions are intended to hedge a commercial risk.

The facts and circumstances that exist at the time the transaction is executed should be considered to determine whether a transaction satisfies the criteria for hedging or mitigating commercial risk. A market participant which in the past has conducted speculative transactions using derivatives may use the end-user exemption for a transaction that meets the conditions set out in section 4.

The determination of whether the risk being hedged or mitigated is commercial will be based on the underlying activity to which the risk relates, not the type of entity claiming the end-user exemption. For example, a not-for-profit entity would not be prevented from

relying on the end-user exemption. That determination will depend on the nature of the activity to which the risk being hedged or mitigated relates. The interpretation of "hedging or mitigating of commercial risk" leaves room for judgment but a flexible approach is needed given the variety of derivatives and potential counterparties that may qualify for the exemption and hedging strategies to which this Instrument applies.

Not extending the end-user exemption to speculative transactions is intended to prevent abuse of the exemption. A counterparty's ability to rely on the end-user exemption for a particular transaction depends on the purpose of the transaction.

Section 11 of NI 94-101 requires a local counterparty to maintain records demonstrating that the conditions to the exemption have been met. To meet this obligation, a local counterparty should develop sufficient policies and procedures to ensure that reasonable supporting documentation is prepared and retained with respect to transactions for which the end-user exemption will be relied upon. We would generally consider several factors in determining what constitutes reasonable supporting documentation, including the sophistication of the local counterparty and the regularity with which it enters into derivatives transactions. Where reasonable, we would expect such documentation to include: the risk management objective and nature of risk being hedged, the date of hedging, the hedging instrument, the hedged item or risk, how hedge effectiveness will be assessed, and how hedge ineffectiveness will be measured and corrected as appropriate.

PART 2
MANDATORY CENTRAL COUNTERPARTY CLEARING

Duty to submit for clearing

5. For a local counterparty that is not a clearing member of a regulated clearing agency**,** we have used the phrase "cause to be submitted" to refer to the local counterparty's obligation. The local counterparty will need to have arrangements in place with a clearing member in advance of entering into a transaction. 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.

The obligation 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 subject to the clearing requirement 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 clearing determination is made in respect of a derivative or class of derivatives, there is another transaction in that same derivative, including a material amendment to it, (as discussed in section 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 requirement to submit for clearing but the

derivative is clearable through a regulated clearing agency, the counterparties have the option to submit the derivative for clearing at any time.

Non-Application

6. Section 5 does not apply to any transaction in a mandatory clearable derivative with an entity listed in section 6. Transactions with an entity listed in section 6 are not subject to the duty to submit for clearing under section 5 even if the other counterparty is otherwise subject to it.

For the purpose of paragraphs (b) and (c), it is our view that the guarantee must be for all or substantially all of the liabilities of the crown corporation or entity wholly owned by a government referred to in paragraph (a).

Notice of rejection

7. The rules of regulated clearing agencies providing for confirmations and rejections of transactions as well as legal arrangements governing indirect clearing, where applicable, should ensure that the counterparties are notified of the rejection of a transaction submitted for clearing.

PART 3
EXEMPTIONS AND APPLICATION

End-user exemption

9. (1) Section 9 exempts a transaction from the clearing requirement under section 5 provided that at least one of the counterparties is not a financial entity as defined in section 1 and such transaction, at the time of execution, is intended to hedge, directly or indirectly, commercial risk related to the operation of the business of one of the counterparties that is not a financial entity. If, after execution of the transaction, circumstances change such that the transaction no longer meets the criteria of hedging or mitigating commercial risk, it will not result in a requirement to submit the transaction for clearing under section 5.

Entities not defined as a financial entity may benefit from the end-user exemption provided the particular transaction meets the interpretation of hedging or mitigating commercial risk in section 4 of NI 94-101.

(2) Certain entities may choose to centralize their trading activities through one affiliated entity. An entity that meets all conditions related to the end-user exemption can have an affiliated entity act on its behalf. The affiliated entity acting on behalf of the entity cannot be an entity subject to, registered under or exempted from the registration requirement under the securities legislation of a jurisdiction of Canada, although it may be a financial entity, provided that the conditions in paragraphs (a), (b) and (c) are met. The end-user

exemption includes subsection (2) to allow affiliated entities that are part of a non-financial group to use the end-user exemption to enter into a market-facing transaction so long as the transaction is a hedge under the Instrument. For a transaction to continue to be considered to hedge commercial risk and qualify under the end-user exemption, the affiliated entity may act only on behalf of the entity, and may not act in this capacity for entities that are not affiliated entities, that is to say it cannot be a dealer.

Intragroup exemption

10. (1) and (2) The exemption for intragroup transactions 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. Entities using this exemption should have appropriate legal documentation between the affiliated entities and detailed operational material outlining the robust risk management techniques used by the overall parent entity and its affiliated entities when entering into the intragroup transactions.

Paragraph 10(1)(a) extends the availability of the intragroup transaction exemption provided for in subsection (2) to transactions among 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.

Subsection (2) sets out the conditions that must be met for the intragroup counterparties to rely on the intragroup exemption for a transaction in a mandatory clearable derivative. Paragraph (b) 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 a group of affiliated entities may structure its centralized risk management according to its unique needs, provided that the program reasonably monitors and manages risks associated with non-centrally cleared derivatives.

(3) Within 30 days of the first transaction between two affiliated entities relying on the section 10 intragroup exemption, a completed Form 94-101F1 *Intragroup Exemption* ("Form 94-101F1") must be submitted to the regulator to notify the regulator that the exemption is being relied upon. The information submitted in the Form 94-101F1 will aid the regulators in better understanding the legal and operational structure being used to allow counterparties to benefit from the intragroup exemption. The obligation to submit 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 submitted for each pairing of affiliated entities that seek to rely upon the intragroup exemption.

(4) Examples of changes to the information submitted that we would consider material include: (i) a change in the control structure of one or more of the affiliated entities listed in
Form 94-101F1, and (ii) any significant amendment to the risk evaluation, measurement and control procedures of an affiliated entity listed in Form 94-101F1.

Record keeping

11. (1) We would generally expect that the reasonable supporting documentation to be kept in accordance with section 11 would include full and complete records of any analysis undertaken by the end-user to demonstrate it satisfies the requirements necessary to rely on the end-user exemption under section 9 or the intragroup exemption under section 10.

With respect to the end-user exemption under section 9, reasonable supporting documentation should be kept for each transaction where the end-user exemption is relied upon, setting out the basis on which the transaction is entered into for the purposes of hedging or mitigating commercial risk, including:

- risk management objective and nature of risk being hedged,
- date of hedging,
- hedging instrument,
- hedged item or risk,
- how hedge effectiveness will be assessed, and
- how hedge ineffectiveness will be measured and corrected as appropriate.

The level of diligence required may vary depending on the circumstances of each counterparty. We would generally expect that, to the extent produced in relation to an end-user counterparty, records to be kept in accordance with section 11 would include documentation of the end-user's macro, proxy or portfolio hedging strategy or program and the results of regular compliance audits to ensure such strategy or program continues to be used for relevant hedging purposes.

In determining whether an exemption is available, a local counterparty may rely on factual representations by the other counterparty, provided that the local counterparty has no reasonable grounds to believe that those representations are false. However, the local counterparty subject to the mandatory central counterparty clearing 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.

PART 4
MANDATORY CLEARABLE DERIVATIVES

and

PART 6
TRANSITION AND EFFECTIVE DATE

12 & 14. 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. 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 *Derivatives Clearing Services* ("Form 94-101F2") will allow the CSA to carry 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, 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 exposures, the current liquidity 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 then 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 could harm competition;

- alternative derivatives or clearing services co-existing in the same market;
- the existence of a clearing obligation in other jurisdictions;
- the public interest.

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

Paragraphs (a), (b) and (c) of item 2 in section 2 of Form 94-101F2 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), life cycle event has the same meaning as in section 1 of the TR Instrument.

Paragraphs (d) and (e) of item 2 in section 2 of Form 94-101F2 provide details needed to assess the extensiveness of the use 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 a determination for central counterparty clearing could have on market participants, including the regulated clearing agency. The determination process will have 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 securities regulator in allowing a regulated clearing agency to offer clearing services for a derivative or class of derivatives. The stability of the pricing availability will also be an important factor considered in the determination process.

APPENDIX A

For each mandatory clearable derivative, the requirement under section 5 to submit, or cause to be submitted, a transaction for clearing does not apply to a local counterparty until both counterparties to a transaction are subject to it pursuant to Appendix A or, in Québec, as determined by the Autorité des marchés financiers. For example, where a transaction is between a counterparty that is a member of a regulated clearing agency that offers clearing services for the mandatory clearable derivative and subscribes to such service and a counterparty that is neither a member of a regulated clearing agency nor a financial entity, section 5 will not apply until 18 months after the date on which section 5 will apply to the first counterparty.

Where a local counterparty enters into more than one category provided in Appendix A or, in Québec, as determined by the Autorité des marchés financiers, the earlier date on

which section 5 applies to it prevails. For example, where a local counterparty is both a member of a regulated clearing agency that offers clearing services for the mandatory clearable derivative and subscribes to such service and a financial entity, its status as a member of a regulated clearing agency prevails for purposes of the date on which section 5 applies.