

Canadian provinces implement derivatives scope and trade reporting rules

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Introduction

Scope rule

Trade repositories rule

Differences between new instruments and Ontario's existing rules

Introduction

On January 22 2016 the securities regulatory authorities in Alberta, British Columbia, Saskatchewan, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nova Scotia, Nunavut, Prince Edward Island and Yukon adopted Multilateral Instrument 91-101 Derivatives: Product Determination and the related Companion Policy (the scope rule) and Multilateral Instrument 96-101 Trade Repositories and Derivatives Data Reporting and the related Companion Policy (the trade repositories rule).

The implementation of these rules comes after the participating jurisdictions published proposed rules in January 2015 for comment (for further information please see "[Provinces announce proposed derivatives product determination and trade reporting rules](#)").

The scope rule is expected to come into force on May 1 2016 (apart from transaction reporting, which will begin on July 29 2016). However, in cases where the reporting counterparty is not a reporting clearing agency or a derivatives dealer, no report is required until November 1 2016. The trade repositories rule comes into force in each of the participating jurisdictions on May 1 2016, subject to any necessary ministerial approval or required amendments. Similar rules are already effective in Manitoba, Ontario and Quebec.

Scope rule

The purpose of the scope rule is to define the instruments that are subject to the trade repositories rule. Initially, the scope rule will be relevant only for this purpose and for the proposed national instrument regarding customer clearing that was recently released. All other legislation, rules, notices or other policies applicable to derivatives continue to apply. However, it is expected that the scope rule will apply, with some amendments, to future rules that address other aspects of derivatives regulation.

The scope rule designates certain instruments as derivatives primarily by defining those that are excluded from being a derivative. Excluded instruments include:

- those regulated by gaming control legislation;
- insurance, income or annuity contracts;
- currency exchange contracts, provided that the contract settles, and is intended by the parties to be settled, by delivery of the contracted currency within two business days and does not permit roll-over;
- commodity forward contracts where physical delivery is intended and the contract generally does not provide for cash settlement;
- evidence of deposits issued by certain Canadian financial institutions; and

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- those traded on certain stock exchanges (specifically excluding swap execution facilities from this exemption).

The scope rule sets out deeming rules for each jurisdiction regarding whether certain types of contracts or instruments are derivatives or securities. Where the contract or instrument is a derivative, the trade repositories rule applies. In certain circumstances, an instrument falling into both definitions is not considered a derivative, including where the instrument is issued by an issuer, control person or insider of the issuer:

- to compensate or incentivise the performance of a director, employee or service provider of the issuer (or its affiliate); or
- as a financing instrument to raise capital for the issuer.

The companion policy to the scope rule clarifies that contracts entered into for consumer, business or non-profit purposes that do not involve investment, speculation or hedging – such as employment contracts, guarantees, contracts for business purchase and sale transactions and commercial sale arrangements – are not derivatives for purposes of the trade repositories rule.

Trade repositories rule

The trade repositories rule covers two matters:

- the requirements to become and operate as a recognised trade repository in the participating jurisdictions; and
- the establishment of derivatives data reporting requirements.

For entities that wish to establish and operate a trade repository in one or more of the participating jurisdictions, the trade repositories rule establishes the application process and addresses ongoing requirements relating to the general operations of a repository, including:

- governance;
- the board of directors;
- management roles and responsibilities;
- the chief compliance officer;
- fees;
- providing access to services;
- the acceptance of reporting;
- general communications;
- due process;
- data records, data security and confidentiality;
- risk management; and
- outsourcing.

The other part of the trade repositories rule addresses the reporting requirements with respect to derivatives transactions. Under the trade repositories rule, detailed derivatives data for each derivatives transaction involving a local counterparty must be reported to a recognised trade repository. Details on the data to be reported are included in Appendix A of the trade repositories rule.

The trade repositories rule provides for the following exemptions from trade reporting:

- commodity trades (other than cash or currency) where:
 - none of the parties to the trade are a clearing agency, a derivatives dealer or an affiliate of a clearing agency or derivatives dealer; and
 - the aggregate month-end gross notional exposure of each counterparty under its commodity derivatives trades was less than C\$250 million in each of the preceding 12 calendar months;
- derivatives trades between the government of a local jurisdiction and a crown corporation or agency whose accounts are consolidated with those of that government; and
- derivatives trades between a non-resident derivatives dealer and a non-local counterparty.

The trade repositories rule includes rules to determine which counterparty will be obliged to report. The intention of the rule is to facilitate data reporting by a single counterparty. Generally, the reporting counterparty is the clearing agency for trades that are cleared through:

- a recognised or exempted clearing agency; or
- a clearing agency not yet recognised or exempted that has provided a written undertaking to the applicable securities regulator to act as the reporting counterparty.

If the transaction is not cleared, the following rules determine which counterparty must report:

- In a transaction between a derivatives dealer and a non-dealer, the reporting counterparty will be the derivatives dealer;
- In a transaction between two derivatives dealers or two counterparties, neither of which is a derivatives dealer, the counterparty is determined to be the reporting counterparty under a written agreement between the parties; and
- In any other case, each local counterparty other than an individual will be a reporting counterparty.

If a written agreement is entered into as referred to above, each local counterparty must keep a record of the agreement for seven years after the expiration or termination date of the transaction.

Under the trade repositories rule, the data that must be reported is categorised into creation data, life-cycle event data and valuation data. The report about the initial creation of a reportable trade is required to be made in real time unless it is not practicable to do so. In that case, it must be done, no later than the end of the next business day. Life-cycle event data regarding an existing trade must be reported by the end of the business day on which the life-cycle event occurs. The timing for the reporting of valuation data depends on the status of the reporting counterparty: derivatives dealers and reporting clearing agencies must report daily, whereas other reporting counterparties must report quarterly.

The trade repository must make certain trade data available to the securities regulators, the counterparties and the public.

Differences between new instruments and Ontario's existing rules

The new instruments are intended to be consistent with the existing rules. However, notable differences are set out in the table below. Further amendments to the trade repositories rule are expected to align it with amendments proposed in Ontario.

	Existing rules in Ontario	New rules
Local counterparty	A derivatives dealer must be registered as a derivatives dealer to be a local counterparty.	Simply engaging in the business of trading in derivatives causes the dealer to be a local counterparty.
Substituted compliance	Reporting obligations can be satisfied if the transaction is reported to a designated trade repository pursuant to the laws of a foreign jurisdiction listed in Appendix B of the existing rules.	Substituted compliance by reporting in compliance with US, EU or other foreign requirements is not permitted. However, it is anticipated that substituted compliance will be implemented.
	For a derivative that is not cleared and is between two derivatives dealers or two end	For a derivative that is not cleared and is

Reporting counterparty	users, the parties can determine the reporting counterparty pursuant to the International Swaps and Derivatives Association's methodology.	between two derivatives dealers or two end users, the parties can designate one party as the reporting counterparty under a written agreement.
Exemptions	Not available in Ontario.	The trade repositories rule exempts trades of commodity (other than currency) if the aggregate month-end gross notional amount under all outstanding derivatives of the non-currency commodity asset class of the local counterparty and certain affiliated entities, excluding derivatives with an affiliated entity, did not exceed C\$250 million in any calendar month during the preceding 12 calendar months.

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