HARMONIZED DERIVATIVES RULES PROPOSED ACROSS MANY CANADIAN PROVINCES

On August 25, 2015, British Columbia, Ontario, Saskatchewan, New Brunswick, Prince Edward Island, Yukon (the CMR Jurisdictions) and Canada released draft legislation and regulations for the implementation of the Cooperative Capital Markets Regulatory System (the Cooperative System). Two of the proposed regulations address the regulation of derivatives: CMRA Regulation 91-501 Derivatives and Strip Bonds (Reg 91-501) and CMRA Regulation 91-502 Trade Repositories and Derivatives Data Reporting (Reg 91-502). In addition, some of the proposed amendments to National Instrument 31-103 (NI 31-103) include derivatives-related provisions. Currently, derivatives legislation in the CMR Jurisdictions is not harmonized. Regs 91-501 and 91-502 are an adaptation of existing rules, forms and policies in the CMR Jurisdictions, but include substantive changes where needed to harmonize requirements.

The draft provincial uniform Capital Markets Act (the PCMA) defines derivatives to be either exchange contracts or over-the-counter (OTC) derivatives. Exchange contracts (a term currently used in British Columbia and Saskatchewan) include commodity futures contracts and commodity futures options (which are currently governed in Ontario under the Commodity Futures Act (Ontario), which Act will be repealed) and instruments that are exchange-traded (this does not include derivatives trading facilities), standardized and for which a clearing agency is the counterparty. All other derivatives are OTC derivatives.

The following table summarizes some of the key proposals in Regs 91-501 and 502 and NI 31-103. Following the table is a discussion of each proposed regulation.

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<td>Registration</td>
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### REGULATORY REQUIREMENTS

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#### Prospectus

All OTC derivatives are prescribed to be securities for purposes of Part 5 (Prospectus requirements) of the PCMA and are therefore subject to the prospectus requirement unless an exemption is available. OTC derivatives that are only securities because of this prescribing are not subject to other, non-prospectus related, requirements that are applicable only to securities.

An exemption from the prospectus requirement is available where each party to the trade is a permitted client or a qualified party, each acting as principal.

Exchange contracts are prescribed not to be securities for purposes of the definition of security in section 2 of the PCMA and are therefore not subject to the prospectus requirement, even if they would otherwise meet the definition of security (i.e., equity options).

Instead, a person registered as a dealer or adviser is required to deliver a risk disclosure statement to a client before the person first purchases or sells an exchange contract for the client, or advises the client to purchase or sell an exchange contract.

Exempt international dealers and advisers are required to provide their Canadian clients with exchange contract risk disclosure, if any, that they would be required to provide to similar clients in their home jurisdictions.

#### Trade reporting

Trade reporting is required for OTC derivatives, with some exceptions, under Regulation 91-502.

Trade reporting is generally not required for exchange contracts under Regulation 91-502.

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**CMRA Regulation 91-501**

**Derivatives and Strip Bonds**

**OTC Derivatives**

Under current legislation, OTC derivatives in British Columbia and Saskatchewan are subject to prospectus requirements; OTC derivatives in Ontario and New Brunswick generally are not. Under Reg 91-501, the prospectus and registration requirements apply to OTC derivatives unless there is an exemption. The registration and prospectus exemptions currently available in British Columbia and granted on a discretionary basis in Ontario are carried forward into Regulation 91-501, which provides for a exemption from the registration and prospectus requirements where each party to the trade is a qualified party or a permitted client, each acting as principal. The Regulators are seeking comments as to whether this exemption should be extended to trades that involve an agent where the beneficial parties to the trade are permitted clients or qualified parties. Given the policy rationale behind the exemption, we believe that the exemption should be extended in this manner.

**Exchange Contracts**

The current dealer and adviser registration exemptions for exchange contracts vary from province to province. Going forward, the status of those exemptions are set out below:

**Dealer Registration Exemptions**

- Trade through a registered dealer exemption – available
- Unsolicited trade exemption – not available
Adviser Registration Exemptions

- Exemption for registered dealers – available
- Exemption for certain professionals – not available, but guidance given on when registration not required
- Generic advice exemption – available
- Exemption for banks – not available
- International sub-adviser exemption – available
- Exemption for performance of advisory services – not available

Reg 91-501 proposes new registration exemptions for foreign persons dealing in or advising on exchange contracts traded on an exchange located outside of Canada and cleared through one or more clearing agencies located outside of Canada. While this exemption is modelled after exemptive relief orders that have been granted to international dealers and advisers, there are three notable differences: the exemptions are only available to a dealer or adviser in the United States and the United Kingdom; the Chief Regulator must be advised of all regulatory action against the dealer or adviser; and Canadian clients must be given the same risk disclosure that is provided to similar clients in its home jurisdiction.

Exempt Derivatives

Reg 91-501 exempts certain types of contracts and instruments that may be caught within the broad definition of derivatives from most requirements other than prohibitions contained in the market conduct provisions in the PCMA, such as prohibitions on fraud and manipulation. Exempt derivatives include gaming and insurance contracts and contracts for the purchase and sale of currency (spot contracts) or the physical delivery of other commodities (subject to certain conditions).

CMRA Regulation 91-502 Trade Repositories and Derivatives Data Reporting

Reg 91-502 is largely based on OSC Rule 91-507 Trade Repositories and Derivatives Data Reporting and OSC Rule 91-506 Derivatives: Product Determination. The Regulators are, however, seeking comment as to the appropriate threshold for the exemption from reporting regarding trades in a derivative that is a contract for a commodity (other than cash or currency) if the local counterparty is not a derivatives dealer.

The current exemption in Ontario is $500,000, whereas the proposed multi-lateral instrument for certain provinces, including British Columbia, Saskatchewan and New Brunswick, suggests a threshold of $250 million.

Derivative-Related Amendments to NI 31-103

The business trigger test for determining the requirement to register as a dealer or adviser is amended to include guidance specifically for derivatives. This guidance clarifies that frequent or regular transactions will not be determinative. For example, commercial hedgers will not necessarily be considered to be in the business of trading derivatives.

No new derivative-specific categories of registration have been created; instead the current categories of registration in NI 31-103 will apply to derivatives. Investment dealers, exempt market dealers and certain restricted dealers will be permitted to trade OTC derivatives; only investment dealers and certain restricted dealers will be permitted to trade exchange contracts.

It is expected that further categories of registration for derivative dealers will be developed as part of the regime being implemented for the regulation of derivatives in Canada.

CONTACT US

If you would like further information, please contact the author of this bulletin or any other member of the BLG Derivatives Group.
BLG is ranked as the Number One Law firm in Canada for Derivatives by Derivatives Weekly and was named Canada Law Firm of the Year at Global Capital’s 2014 and 2015 Americas Derivatives Awards. BLG’s Derivatives Group is a multi-disciplinary team of lawyers that cuts across several of our practice groups. The lawyers in BLG’s Derivatives Group are experienced in negotiating derivatives documentation with sell-side and buy-side market participants around the world. Our clients include financial institutions, investment dealers, futures commission merchants, market intermediaries, securitization conduits and a wide variety of derivative end-users, such as mutual funds, hedge funds, pension funds, other investment vehicles, commodity producers, real estate firms, insurance companies, risk management firms and other corporate end-users. Our advice covers derivative structuring and document negotiation, regulatory compliance, tri-party collateral control practices and close-out issues. We also advise on compliance and registration requirements relating to derivatives in Canada and the United States.

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