

Structured Finance and Derivatives

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Canadian Securities Regulators Adopt New Rules for OTC Derivatives Clearing

On January 19, 2017, the Canadian Securities Administrators (CSA) announced two new instruments affecting over-the-counter (OTC) derivatives trading in Canada. National Instrument 94-101 *Mandatory Central Counterparty Clearing of Derivatives* (“**NI 94-101**”) and National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions* (“**NI 94-102**”), represent part of the ongoing implementation of Canada’s commitment under the G20 agreement of 2009 to reform derivatives markets in response to the global financial crisis.

In some jurisdictions, ministerial approvals are required for the implementation of these instruments. Assuming all necessary approvals are obtained, NI 94-101 will come into effect on April 4, 2017, and NI 94-102 will come into effect on July 3, 2017.

Mandatory Central Counterparty Clearing of Derivatives

NI 94-101 imposes mandatory central counterparty clearing for certain standardized OTC derivatives. NI 94-101 is comprised of two main parts: (i) the classification of certain interest rate derivatives (IRD) as “mandatory clearable derivatives,” and (ii) the requirements for counterparty clearing of mandatory clearable derivatives by certain counterparties (including exemptions).

The first part of NI 94-101 classifies certain types of IRDs denominated in U.S. dollars, euros, British pounds and Canadian dollars as “mandatory clearable derivatives.” Appendix “A” of NI 94-101 contains a

comprehensive list of mandatory clearable derivatives. The CSA has attempted to harmonize the list with the practices already in place in the United States, Europe and Australia.

The second part of NI 94-101 provides that a local counterparty to a transaction in a mandatory clearable derivative must submit that derivative to a clearing agency when each counterparty meets one or more of the following criteria:

- a) the counterparty is a participant subscribing to the services of a regulated clearing agency for a mandatory clearable derivative;
- b) the counterparty is an affiliated entity of a participant described in a) and has an aggregate gross notional amount exceeding \$1 billion in outstanding OTC derivatives, excluding intragroup transactions; or
- c) the counterparty is a local counterparty that, together with its local affiliated entities, has an aggregate gross notional amount exceeding \$500 billion in outstanding OTC derivatives, excluding intragroup transactions.

NI 94-101 lists a number of exempt entities which are not subject to the clearing requirements, including certain governmental and intergovernmental entities. The instrument also exempts transactions between affiliated entities that have consolidated financial statements as well as transactions undertaken to consolidate swap positions among a number of counterparties. A counterparty relying on either exemption must keep detailed records to demonstrate its eligibility for the exemption.

Customer Clearing and Protection of Customer Collateral and Positions

NI 94-102 is designed to protect customer collateral and positions when clearing OTC derivatives, and to

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improve clearing agencies' resilience to default by a clearing intermediary. NI 94-102 mandates new requirements for clearing intermediaries and clearing agencies in three main areas:

- Segregation and Use of Customer Collateral:

NI 94-102 outlines new rules for clearing agencies and clearing intermediaries in respect of handling a customer's collateral. Specific requirements relate to the collection, holding and maintenance of customer collateral, the identification of excess margin, the collection of initial margin (for clearing agencies), as well as the segregation, use and investment of customer collateral. Clearing intermediaries are also subject to additional risk management requirements in connection with providing clearing services to local customers.

- Recordkeeping and Disclosure: NI 94-102 requires clearing agencies and clearing intermediaries to keep up-to-date records and supporting documentation to facilitate the identification and protection of a customer's positions and collateral. Clearing agencies and clearing intermediaries are also required to disclose certain information to their customers relating to the use, transfer and investment of their collateral.

- Portability of Customer Collateral and Positions:

NI 94-102 sets out the requirements for a clearing agency to facilitate the transfer of a customer's positions and collateral in the context of a clearing intermediary's default or at a customer's request. It also requires a clearing intermediary that provides clearing services to an indirect intermediary to have policies and procedures for transferring the positions and collateral of a customer of the indirect intermediary.

Not all clearing agencies and clearing intermediaries are subject to this instrument. NI 94-102 provides a mechanism for substituted compliance, whereby clearing agencies and clearing intermediaries located outside of Canada may be exempt from the instrument if they comply with the comparable requirements of a foreign jurisdiction.

For further information regarding these instruments or OTC derivatives in general, please contact Francesca Guolo or Lisa Mantello of the Goodmans Structured Finance and Derivatives Group.