

# APPROACHING HARMONIZATION: REPORTING TO GO LIVE ACROSS CANADA

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On January 21, 2015, the securities regulatory authorities in Alberta, British Columbia, New Brunswick, Nova Scotia and Saskatchewan published for comment Proposed Multilateral Instruments 91-101 *Derivatives: Product Determination and 96-101 Trade Repositories and Derivatives Data Reporting* (the proposed **TR Rule**).<sup>[1]</sup> Just over a year later, on January 22, 2016, the authorities in these jurisdictions, joined by Prince Edward Island, Newfoundland and Labrador, the Northwest Territories and Yukon (collectively, the **Participating Jurisdictions**), adopted final versions of these Multilateral Instruments and their respective companion policies.

Together, the instruments form a derivatives reporting regime that is substantively harmonized with existing local trade reporting rules in Manitoba, Ontario and Quebec (the **MOQ Rules**), and will come into force in each of the Participating Jurisdictions on May 1, 2016.

The deadline for derivatives dealers and clearing agencies to report transactions entered into on or after May 1, 2016 is **July 29, 2016**.

The deadline for end users to report transactions entered into on or after May 1, 2016 is **November 1, 2016**.

The deadline for derivatives dealers and clearing agencies to report pre-existing transactions (those entered into before May 1, 2016) is **December 1, 2016**.

The deadline for end users to report pre-existing transactions is **February 1, 2017**.

Finally, end-users may delay reporting of new inter-affiliate transactions until **January 1, 2017**.

Following Canada's G20 commitments for the regulatory reform of over-the-counter (OTC) derivatives, the rules improve transparency in the OTC derivatives market and ensure that recognized trade repositories operate in a manner that promotes the public interest. In response to the comments received on the proposed TR Rule, the authorities in the Participating Jurisdictions (the Authorities) made the changes discussed below.

## Changes to the Product Determination Rule

With respect to the product determination rule, notwithstanding the additional guidance provided in its

companion policy relating to physically-settled commodity options, regulated pool arrangements, and exchange-traded derivatives, the rule remains substantively similar to the MOQ Rules.<sup>[2]</sup>

## **Changes to the TR Rule**

### *"Local Counterparty" Definition*

The definition of "local counterparty" has been revised to conform more closely with the definition in the MOQ Rules. "Derivatives dealer" has been reinserted into the definition of "local counterparty", and a corresponding new exclusion has been added: under the new section 42, derivatives between a non-resident derivatives dealer and another non-resident counterparty are now exempt from the reporting requirements. In addition, the definition has incorporated the "all or substantially all" language that had been expressed in relation to the concept of a "guaranteed affiliate" from the proposed companion policy to the TR Rule. Specifically, part (c) of the definition of "local counterparty" captures entities affiliated with a person or company referred to in part (a) of the definition, provided that such party guarantees all or substantially all of the affiliate's liabilities. Finally, "individual" has been removed from the definition of "local counterparty", consistent with the MOQ Rules.

### *"Reporting Counterparty" Definition*

"Canadian financial institution" has been removed from the reporting counterparty hierarchy (former section 25(1)(c)), consistent with the Ontario rule.<sup>[3]</sup> In the interest of harmonization with the MOQ Rules, the adopted TR Rule removed the proposed requirement to submit the derivative's unique transaction identifier, where counterparties cannot agree on which will be the reporting counterparty. The companion policy further illuminates several aspects of identifying a derivatives dealer for the purposes of the TR Rule: the jurisdiction in which an entity conducts its activities; the relevant factors to be considered in determining whether an entity is a derivatives dealer; and the entity's actual activities, examined holistically. In addition, section 26(6) (formerly section 26(8)) now requires a reporting counterparty to report an error or omission "as soon as practicable" after discovery, rather than "as soon as technologically practicable". This language is consistent with the MOQ Rules. The companion policy expounds on this requirement to mean "upon discovery", and in any case no later than the end of the business day on which the error or omission is discovered.

### *Commodity Derivatives*

The exclusion relating to commodity derivatives has been revised with respect to when and how a counterparty's notional amount outstanding should be calculated for the purpose of the threshold. The TR Rule now explicitly refers to the scope of instruments considered to be "derivatives" under the TR Rule, and specifies the scope of contracts to be included in the calculation of a counterparty's month-end gross notional amount outstanding.<sup>[4]</sup> For greater clarity, the exemption provision now provides that a local counterparty qualifies for

the exemption if it stays below the prescribed threshold amount (i.e. \$250 million) in the preceding 12 months. In addition, the companion policy makes clear that notional amount currency conversions are made at the time of the transaction, based on official published exchange rates.

### *Other Changes*

Other changes in the TR Rule include increased flexibility in the assignment of a unique product identifier (UPI) when a UPI is not available in a particular taxonomy. The Authorities have also clarified the requirements relating to reporting pre-existing derivatives: sections 34(1)(c) and 34(2)(c) of the TR Rule now provide that contractual obligations be outstanding as of the earlier of the date that the derivative is reported or the relevant deadline for reporting pre-existing derivatives. Otherwise, a reporting counterparty would not be able to predict which derivatives would be subject to a negotiated unwind, novation, credit event or other termination event that would render the trade no longer reportable, and thus may breach data privacy restrictions.

In addition, proposed amendments to the provisions relating to public dissemination of certain transaction-level data are anticipated in the near future, and the Authorities have indicated that they will be largely consistent with the recent amendments to the MOQ Rules. Aside from these forthcoming changes, the instruments are otherwise in their final form.

## **Differences between the TR Rule and the MOQ Rules**

### *Limited Exemption from Reporting Trades of Commodities Derivatives*

In the MOQ Rules, there is currently an exemption for transactions involving derivatives whose asset class is a commodity other than cash or currency, and which involve a local counterparty who is not a derivatives dealer. To qualify, the counterparty must have less than \$500,000 aggregate notional value, without netting, under all its outstanding transactions at the time of the transaction, including the additional notional value related to that transaction. The threshold aggregate value under the TR Rule, meanwhile, is **\$250 million**.<sup>[5]</sup> The intent of raising the financial threshold was to mitigate the regulatory burden on commodity derivatives market end-users, while still ensuring that the majority of derivatives transactions continue to be reported.

### *"Affiliated Entity" Definition*

In the TR Rule, a person or company is an "affiliated entity" of another person or company if one of them controls the other or if each of them is controlled by the same person. "Control" has been given a very broad definition to include a beneficial owner of securities; a direct or indirect holder of securities; an owner of 50% of the interests in a partnership; the general partner of a limited partnership; or the trustee of a trust.

Under the definition in the proposed TR Rule, and unlike the MOQ Rules, affiliated partnerships and trusts guaranteed by an entity located in the jurisdiction are captured in the definition of "local counterparty". Notably, however, the *Autorité des marchés financiers* published for comment proposed amendments to Quebec's local trade reporting rule that broaden the concept of "affiliated person" to include trusts and partnerships.

### *Reporting Hierarchy*

Both the TR Rule and the MOQ Rules establish a hierarchy for determining which counterparty will be required to report a derivative. However, there are still some differences. For example, unlike the Ontario rule, which only allows a recognized or exempt clearing agency to be a reporting counterparty, the TR Rule allows a clearing agency that has not yet been recognized or exempted from local jurisdiction to fulfill the relevant reporting obligations. This is consistent with the local rules in Manitoba and Quebec.

In addition, "Canadian financial institution" is no longer a distinct category within the reporting counterparty hierarchy in the TR Rule, which is consistent with the Ontario rule, but differs from the Manitoba and Quebec rules. Thus, a Canadian financial institution that is not otherwise a derivatives dealer is no longer designated as the reporting counterparty with respect to trades with a party that is neither a derivatives dealer nor a Canadian financial institution.

Further, in Ontario, counterparties are required to follow the International Swaps and Derivatives Association, Inc. (ISDA) reporting methodology. In comparison, for a derivative that is not cleared and is between two derivative dealers or two end-users, the TR Rule and Manitoba and Quebec rules allow the parties to the transaction to designate one party as the reporting counterparty under a written agreement.

### **Conclusion**

After considering the comments received on the proposed instruments, the Authorities revised the TR Rule and companion policy to reflect current market practices. In its effort to harmonize with the MOQ rules, while preserving its regulatory and public transparency objectives, the Authorities reconciled key jurisdictional differences and clarified potential deficiencies in the proposed TR Rules, while preserving some differences (such as the commodity derivatives reporting exemptions) that reflect the nature of the derivatives markets in the Participating Jurisdictions. The adoption of these instruments paves the path toward improving regulatory oversight of the entire Canadian OTC derivatives market and enhancing regulators' ability to address systemic risk and market abuse.

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[1] See McMillan LLP, "[\*Different But The Same: Five Additional Provinces Propose OTC Derivatives Trade\*](#)"

[Reporting Rules](#)" (February 2015.)[ps2id id='1' target=""]

[2] For a discussion of the amendments to the MOQ Rules, see McMillan LLP, "[Leak Tweak: Regulators Balance Posttrade Transparency and Market Efficiency with Latest Amendments to OTC Derivative Trade Reporting Rules](#)" (November 2015.)[ps2id id='2' target=""]

[3] "Canadian financial institution" has also been removed from the valuation data reporting provisions (MI 96-101, s 33(1)).[ps2id id='3' target=""]

[4] The exclusion in section 40 applies only to a derivative the asset class of which is a commodity other than currency; it does not apply to a person or company that is a clearing agency or a derivatives dealer, or an affiliated entity of a clearing agency or a derivatives dealer, even if the person or company is below the \$250 million threshold. In calculating the month-end notional outstanding for any month, the notional amount of all outstanding derivatives relating to a commodity other than cash or currency, with all counterparties other than affiliated entities, whether domestic or foreign, should be included (96-101 CP).[ps2id id='4' target=""]

[5] However, the calculation of the notional amount outstanding for the purposes of the threshold under the revised provision now requires including all outstanding commodity-based derivatives entered into by a local counterparty and each affiliated entity that is also a local counterparty in a jurisdiction of Canada, excluding inter-affiliate derivatives.[ps2id id='5' target=""]

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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