

# DIFFERENT BUT THE SAME: FIVE ADDITIONAL PROVINCES PROPOSE OTC DERIVATIVES TRADE REPORTING RULES

Posted on February 4, 2015

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Following the global financial crisis, Canada committed to increasing its regulation of derivatives. In response to Canada's G20 commitments, the securities regulators in Manitoba, Ontario and Quebec enacted rules, which were subsequently amended, which govern the reporting of derivatives transactions (the "**MOQ Rules**", as described in our earlier [bulletins](#)).<sup>[1]</sup> The securities regulators in Alberta, British Columbia, Saskatchewan, New Brunswick and Nova Scotia (the "**Authorities**") followed suit, first publishing Model Provincial Rule 91-302 *Updated Model Provincial Rules – Derivatives: Product Determination and Trade Repositories and Derivatives Data Reporting* and, more recently, on January 21, 2015, publishing proposed Multilateral Instrument 91-101 *Derivatives: Product Determination* and proposed Multilateral Instrument 96-101 *Trade Repositories and Derivatives Data Reporting*, along with their accompanying companion policies (the "**Proposed Rules**") for comment.

Although the Proposed Rules are substantially similar to the MOQ Rules, there are several key differences which are discussed below.

## "Local Counterparty" Definition

Under both sets of rules, derivative transactions involving a "local counterparty" are required to be reported to a designated or recognized trade repository. However, the definition of "local counterparty" is broader in the MOQ rules than in the Proposed Rules. The definition of "local counterparty" under the MOQ Rules includes an entity situated in the local jurisdiction (or any affiliates that it substantially guarantees the liabilities of) and entities registered under the applicable securities law as a derivatives dealer or in an alternative category due to derivatives trading activities (it should be noted that at present only Quebec has such a registration requirement).

In comparison, under the Proposed Rules, "local counterparty" only includes a person/company situated in the local jurisdiction (or any affiliated entities that it substantially guarantees the liabilities of). The practical effect of this difference in definition is that more transactions are required to be reported under the MOQ Rules as compared to the Proposed Rules. It should be noted that the "substituted compliance" regime under the MOQ

Rules is intended to address this issue and so long as a registered derivatives dealer limits transactions to regimes which the MOQ Rules have deemed acceptable for "substituted compliance", there should be no difference in the scope of reporting under either set of rules.

### **"Affiliated Entity" Definition**

The Proposed Rules have changed the term "affiliate" or "affiliated companies" in the MOQ Rules to "affiliated entity" or "affiliated entities." This will impact how the Authorities identify a local counterparty and the determination of which trades a trade repository must disseminate publicly. The term "affiliated entity" considers a person or company affiliated with another if one of them controls the other or each is controlled by the same person. Furthermore, control has been given a very broad definition, which includes beneficial ownership or direct/indirect control over securities, owning 50% or more of the interests in a partnership, being the general partner of a limited partnership, or being the trustee of a trust.

Under the definition in the Proposed Rules, and unlike the MOQ Rules, affiliated partnerships and trusts guaranteed by an entity situated in the jurisdiction are captured in the definition of "local counterparty". Similarly, under the Proposed Rules, trade repositories will not be required to publicly disseminate derivatives data for transactions entered into between a local counterparty and affiliated partnerships or trusts.

### **Reporting Hierarchy and Other Additional Requirements**

Both the MOQ Rules and Proposed Rules set out a hierarchy which indicates which party to a derivative transaction will be required to report a trade. However, Ontario's hierarchy rules differ from the Proposed Rules and Manitoba's and Quebec's trade reporting rules. The main differences are as follows:

1. While Ontario only allows a recognized or exempt clearing agency to be a reporting counterparty, the Proposed Rules and Manitoba's and Quebec's trade reporting rules allow for a clearing agency that has not yet been recognized or exempted from local jurisdiction to fulfill the reporting obligations for a transaction cleared through its facilities.
2. For transactions that are not cleared through a reporting clearing agency, the Proposed Rules and Manitoba's and Quebec's trade reporting rules require Canadian financial institutions that are not derivatives dealers to report a derivatives transaction with a counterparty that is not a derivatives dealer or another Canadian financial institution.
3. In Ontario, counterparties are required to follow the International Swaps and Derivatives Association, Inc. ("ISDA") reporting methodology. In comparison, for transactions between parties that are either both derivatives dealers, both Canadian financial institutions or both local counterparties, the Proposed Rules and Manitoba's and Quebec's trade reporting rules allow counterparties to agree in writing which of them will be the reporting counterparty.

The intent behind these changes is to reduce incidents of double reporting and to reduce the regulatory burden, particularly for counterparties that are not derivatives dealers or Canadian financial institutions.

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

In the MOQ Rules there is currently an exemption for commodities derivatives transactions other than those involving a currency that involve a local counterparty who is not a derivatives dealer and who has 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 Proposed Rules provide for a materially different exemption which raises the financial threshold from \$500,000 to \$250 million. The intent behind raising the financial threshold is to reduce the regulatory burden on commodity derivatives market end-users while still ensuring that the majority of derivatives transactions continue to be reported.

### **Additional Guidance on the Exclusion of Commodities Contracts with Physical Delivery**

Additional guidance has been provided under the Proposed Rules to address optionality with respect to the volume, quantity, timing or manner of delivery of a commodity. This additional guidance indicates that the exclusion will be available where optionality in the commodity contract is consistent with the parties intent to settle the contract by physical delivery of the commodity and not by cash or any other means. However, similar language in the MOQ Rules' Companion Policies indicates that it is unlikely this additional guidance signifies any shift in the Authorities' interpretation of the exclusion.

### **Conclusion**

The Authorities intend that the Proposed Rules be consistent with the MOQ Rules other than minor variations to accommodate differences in provincial securities legislation and the major differences outlined above, including the change in the definition of "local counterparty" and "affiliate" and the higher exemption threshold for commodities derivatives. Consequently, internal procedures developed by a derivatives dealer to satisfy the reporting obligations under the MOQ rules can be used as a basis for compliance with the Proposed Rules as long as allowance is made for the possibility that there may be a broader group of affiliated entities in a province using the Proposed Rules (noting that the commodity derivatives exemption has no application to trades with a derivatives dealer).

The Authorities encourage market participants and the public to submit comment letters addressing any issues or raised by the Proposed Rules. Comments must be submitted by **March 23, 2015**.

We invite market participants to discuss any comments and questions with us. We are available to assist those

wishing to submit comments to the Authorities regarding the Proposed Rules.

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[1][ps2id id="1" target=""] See McMillan LLP Derivatives Law Bulletins [\*"More Amendments, Less Harmony?: Canadian Regulators Propose Amendments to OTC Derivatives Trade Reporting Rules"\*](#) (July 2014), [\*"Canadian Regulators Respond to Concerns of OTC Derivatives Market Participants: OSC Makes Amendments to Trade Reporting Rules"\*](#) (April 2014) and [\*"The last word on reporting: final Ontario rules with respect to trade reporting released"\*](#) (November 2013).

### **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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